

***United States Court of Appeals  
for the Second Circuit***



**BRIEF FOR  
APPELLANT**





ORIGINAL

77-6148,6154

To be argued by  
MAURICE N. NESSEN

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United States Court of Appeals  
FOR THE SECOND CIRCUIT

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duPONT GLORE FORGAN INCORPORATED, *et al.*,  
*Plaintiffs-Appellants,*

—against—

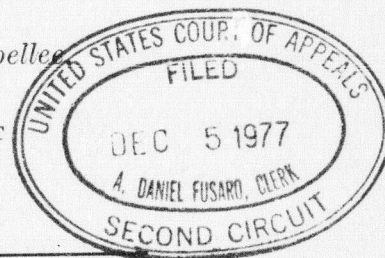
AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *et al.*,  
*Defendants and Third Party*  
*Plaintiffs-Appellees-Appellants,*

—against—

UNITED STATES OF AMERICA,  
*Third-Party Defendant-Appellee*

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK



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BRIEF OF PLAINTIFFS-APPELLANTS

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KRAMER, LOWENSTEIN, NESSEN,  
KAMIN & SOLL  
*Attorneys for Plaintiffs-Appellants*  
919 Third Avenue  
New York, New York 10022  
(212) 688-1100

MAURICE N. NESSEN  
ROBERT M. HELLER  
MICHAEL S. OBERMAN  
GREG A. DANILOW  
*Of Counsel*

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UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

- - - - - x  
:  
DUPONT GLORE FORGAN INCORPORATED, :  
et al., :  
Plaintiffs-Appellants, : Docket Nos. 77-6148  
77-6154  
-against- :  
AMERICAN TELEPHONE AND TELEGRAPH :  
COMPANY, et al., :  
Defendants-Appellees :  
and Third-Party Plain- :  
tiffs-Appellants, :  
-against- :  
UNITED STATES OF AMERICA, :  
Third-Party Defendant- :  
Appellee. :  
- - - - - x

BRIEF OF PLAINTIFFS-APPELLANTS

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UNITED STATES COURT OF APPEALS  
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DUPONT GLORE FORGAN INCORPORATED,  
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Plaintiffs-Appellants, : Docket Nos. 77-6148  
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AMERICAN TELEPHONE AND TELEGRAPH :  
COMPANY, et al., :  
Defendants-Appellees :  
and Third-Party Plain- :  
tiffs-Appellants, :  
-against- :  
UNITED STATES OF AMERICA, :  
Third-Party Defendant- :  
Appellee. :  
- - - - - x

BRIEF OF PLAINTIFFS-APPELLANTS

PRELIMINARY STATEMENT

Plaintiffs-appellants ("plaintiffs"), some of the largest customers of telephone service in the United States (192a, 414a)<sup>1</sup>, appeal from a judgment of the United States District Court for the Southern District of New York dismissing all counts of their class action complaint against

1. We refer to the pages of the Appendix in this case by giving the page number followed by "a". We cite to pages of the separate Exhibit Volumes by putting the letter "E" before the page number. All emphasis in quotations is supplied.



American Telephone and Telegraph Company ("AT&T") and 23 of its subsidiaries and controlled operating companies (collectively "defendants" or "the Bell System defendants"<sup>2</sup>). District Court Judge Edward Weinfeld filed the Court's judgment on August 5, 1977, embodying the results of two decisions of his -- one before trial (428 F. Supp. 1297; 190a-218a) and one after trial (100a-189a).

#### QUESTIONS PRESENTED

In this case, we charged the Bell System defendants with (i) violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, and (ii) breach of duty arising out of the Excise Tax Reduction Act of 1965, 79 Stat. 136 ("the Reduction Act"). We alleged that from 1965 to 1971 defendants -- out of their own self-interest -- agreed not to unbundle their charges for so-called Centrex service<sup>3</sup> so that subscribers to that service could save money on federal communications excise taxes that the

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2. The suit was brought by subscribers to so-called "Centrex" telephone service. The class of subscribers is over 1,000. The District Court certified the case as a class action in an opinion that plaintiffs do not challenge here (69 F.R.D. 481 (1975); 219a-239a).

3. Centrex is the name the Bell System gave to a telephone service which -- like other business systems -- provided a customer with the capabilities of (i) inter-office communication, so-called "private communication service," and (ii) access from each telephone ("station") to the outside (the now familiar dial "9" system), a service called "exchange access." In par-

(Footnote continued on following page)



Congress said they would (but only when defendants unbundled these charges).

We accused defendants, alternatively, of overcollecting excise taxes on Centrex service. We alleged that, in fact, their own books and records always contained information sufficient to constitute a "separate charge," and, accordingly, the excise tax should not have been billed to the plaintiff class on the portion of Centrex charges attributable to "private communication service" after 1965.

Judge Weinfeld's decisions dismissing these various charges raise the following questions for this Court:

Questions as to our antitrust claim:

1. Under the antitrust laws' tests of combination, agreement and conspiracy did the District Court err in reaching the conclusion of no agreement, no combination and no conspiracy among defendants concerning Centrex rate structure in view of: (i) AT&T's leadership of, its "recommendations" and "ada-

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(Footnote continued from preceding page)

ticular, Centrex is characterized by (i) direct connection from the outside to each station ("DID" or "Direct Inward Dialing") and (ii) identification for billing purposes of the particular station making an outgoing call ("IOD" or "Identified Outward Dialing"). Between 1965 and 1971, defendants' tariffs provided for a single package rate for Centrex service, a rate which did not break out separately the inter-office communication and exchange access components.



mant advice" to, and its influence over, all the other Bell System defendants, (ii) meetings among representatives of defendants to formulate and implement Centrex rate structure, (iii) interlocking directorates and management, (iv) peer and supervisory pressures enhanced by a pattern of tours of service by personnel up and down and across the Bell System, and (v) conscious, non-coincidental action first to bundle, then not to unbundle and finally to unbundle Centrex charges?

2. Is an agreement, combination or conspiracy to present a single nationwide rate structure, and no other, an agreement, combination or conspiracy to fix prices and thereby a per se violation of Section 1 of the Sherman Act?

3. If it not be a per se violation of Section 1 of the Sherman Act, is an agreement, combination or conspiracy among licensed monopolists to maintain only a single price structure and no other -- for fear of "opening up a can of worms" with their state tariff regulators, including review of their overall rates of return, and in pursuit solely of their own self-interest -- an unreasonable restraint of trade under Section 1 of the Sherman Act?

Question as to our breach of duty claim:

4. Did the Reduction Act require that the Bell System defendants unbundle their Centrex charges within a

reasonable time so as to provide a "separate charge" for "private communication service" within the meaning of Section 4252(d) of the Reduction Act and thereby save their customers millions of dollars that the Congress said they could save?

Question as to our overcollection claim:

5. Can a person who has overpaid federal excise taxes to a private collecting agent of the Government, as a result of that agent's error, recover from that agent for the overcollection?

#### STATEMENT OF THE CASE

##### Proceedings Below

##### The complaint

Plaintiffs filed the complaint against AT&T and its 23 operating companies in June of 1973 (2a). The complaint came about because Congress passed the Reduction Act, which exempted "private communication service" from the federal communications excise tax imposed on local telephone service (including Centrex), but conditioned the exemption on there being "a separate charge" for the "private communication service." None of the Bell System defendants gave their customers the benefit of the exemption for over 6 years. They simply refused to unbundle Centrex charges in order to isolate the "private communication" element. Rather, they decided to



charge and collect a tax on the entire Centrex charge with no reduction for "private communication service" (163a). All defendants agreed to continue undiminished the excise tax on Centrex.

The complaint posited three theories of liability, which were refined in pre-trial procedures.

First, it charged an agreement, combination or conspiracy among the Bell System defendants to maintain a uniform Centrex rate structure throughout the Bell System -- price-fixing -- in violation of Section 1 of the Sherman Act. The damage to plaintiffs: the payment of taxes that they should not have had to pay. The benefit to defendants: many; including the evasion of state rate-watchers.

Second, plaintiffs claimed that the Reduction Act reposed an obligation on the Bell System defendants to isolate the charges for private communication within a reasonable time after the Reduction Act passed. Congress did not intend to give the Bell System carte blanche to determine when the federal tax would be imposed or not. And the statute is instinct with the obligation that the Bell System defendants, licensed monopolists, act diligently and reasonably. Indeed, the Reduction Act must be interpreted to require that defendants move within a reasonable time in order to avoid a serious constitutional issue.

Third, as an alternative theory to the other two, we alleged that the operating companies in the Bell System had -- from 1965 through 1971 -- sufficient information in their books and records about the private-service element of their Centrex rates to satisfy the "separate charge" requirement of the Reduction Act; the charge was there without further need to split it out. Nevertheless, defendants billed and collected the tax on the entire Centrex service. In so doing, they erred -- the tax was not due on that private communication element. This portion of the complaint asked for a "refund" of the taxes erroneously "overcollected," rather than damages for an anti-trust violation or for a breach of duty in not creating a separate charge.

#### The District Court's decisions

On the third claim for overcollection (embodied in counts II, IV and VI of the complaint), defendants impleaded the United States of America. Following the District Court's certification of this case as a class action, the United States moved for summary judgment and defendants moved for partial summary judgment dismissing the overcollection pleading. Defendants and the Government urged that plaintiffs could not sue private tax collectors for a refund but must sue only the Government under procedures set for refund suits. The District Court granted the motions on March 23, 1977 (190a-218a). And so the District Court held a trial only on the antitrust and



breach of duty claims.

The case was tried before Judge Weinfeld, without a jury, beginning on May 5, 1977, and continuing on May 6, 9, 10, 11 and 12, 1977 (16a). The trial was fundamentally "on papers." Lengthy stipulations of facts reduced courtroom time to a minimum (412a-522a). Plaintiffs called no live witnesses; rather we offered 156 exhibits into evidence (E1-E329, E335-E359, E365-E1331, E1337-E1452, E1462-E1653, E1751-E1752) and read portions of 10 depositions of Bell System defendants' officers and employees (599a-617a, 673a-718a, 738a-747a, 752a-779a, 783a-854a, 874a-912a, 914a-926a, 928a-951a, 956a-970a, 1046a-1058a, 1067a-1119a, 1479a-1484a). Defendants put 11 exhibits into evidence (E330-E334, E360-E364, E1332-E1336, E1453-E1461, E1654-E1750, E1755), and called but four witnesses, employees of only 3 of the 24 defendants: Kenneth A. Hamming, General Pricing Supervisor, Michigan Bell Telephone Company; Arthur X. Ichter, Product Management Supervisor, The Bell Telephone Company of Pennsylvania; Robert M. Kemp, Manager, Docket Number 20003 of AT&T; and Robert D. Weber, Business Relations Manager of AT&T (1166a, 1325a, 1407a, 1449a).

On July 19, 1977, Judge Weinfeld handed down an opinion that ruled completely against plaintiffs (100a-189a). He concluded that there was no conspiracy -- indeed, no agreement or combination among the Bell System defendants on Centrex rate structure. He also held that, even if there had been an

agreement, combination or conspiracy, there was no illegal restraint of trade. He believed that agreement on rate structure would not be a per se price-fixing violation, and it was not an unreasonable restraint of trade for the defendants to refuse to unbundle their Centrex rates. Then, he found no duty outside the antitrust laws that required the Bell System defendants to unbundle Centrex charges; it was all up to them.

#### The Facts

The Bell System: combination  
with a multitude of glues

Judge Weinfeld said in his opinion dismissing the counts that went to trial: "[T]he relationship among the defendants is of crucial significance in considering whether the evidence supports a finding of conspiracy" (158a). We would amend, to avoid the pejorative of "conspiracy" and to focus on price-fixing: understanding the defendants' relationship is crucial to considering whether the evidence supports an "agreement" or a "combination" that involves fixing rate structure.

These defendants are not unrelated entities drawn together for the first time by plaintiffs' complaint. Rather, defendants are all members of the largest corporate enterprise in the world -- the Bell System, with total assets in 1972 of \$60,625,045,000 (414a). AT&T is at the apex. It owns 100% of the capital stock of 16 of the 23 operating companies, at least



85% of the capital stock of 5 others, 26% of the capital stock of defendant Cincinnati Bell, Inc. and 18% of the capital stock of defendant Southern New England Telephone Company (106a, 429a-435a).

But AT&T's binding of the companies into the Bell System does not rest on the power of its stock ownership alone. We have in AT&T and its controlled companies the quintessence of the organization. As the District Court found, the affiliations and contact among the defendants are close and continuous (106a-107a, 158a).

AT&T has entered into comprehensive agreements with all of the other Bell System defendants. These agreements allow the operating companies, legalized monopolies, to connect their telephone lines into AT&T interstate lines. AT&T, in turn, commits itself to license its equipment, to supply hardware, to give financing and to furnish all kinds of technical, commercial, accounting, legal, and other "advice" and services to the companies. In the words of one AT&T witness, AT&T provides the "staff resource" for the operating companies (158a, 1328a; E1-E57).

The entanglement of the Bell System defendants is guaranteed by the positioning of personnel and by a steady flow of contacts arranged by AT&T. With the exception of Cincinnati Bell, an officer of AT&T sits on the Board of Directors of each

of the operating companies (106a-107a). The presidents of all the operating companies are chosen only with the approval of AT&T's Board Chairman (106a-107a). Personnel move constantly and deliberately around the Bell System -- from operating companies to AT&T; from AT&T to operating companies; from one operating company to another operating company (107a).<sup>4</sup> The operating companies send representatives to week-long policy seminars conducted by AT&T; there are Bell System departmental conferences and a steady stream of communications among the companies (158a, 415a, 600a-602a, 612a-613a).

The fundamental policies of the Bell System are established by AT&T through its Executive Policy Committee, which meets almost monthly with operating companies' presidents (E87). Of course, high level officers of the operating companies can "make an initial input" on policy issues; but the final result has to be, and is invariably, adherence to the "advice," "recommendations" or what-have-you of AT&T on policies once decided (607a-615a; E87). Conformity to policy

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4. It should be noted that the only trial witnesses were products of Bell System cross-pollination. Thus, Arthur X. Ichter, now of Pennsylvania Bell, whose "independent actions" were stressed by the District Court, spent several years in AT&T's rate division, working for the two current AT&T employees who testified at the trial, Robert M. Kemp and Robert D. Weber (1450a-1451a, 1474a). In turn, Kemp and Weber were rotated to AT&T's rate division out of Michigan Bell and New York Telephone (1169a, 1326a). The fourth witness, Kenneth Hamming, presently of Michigan Bell, also had worked in AT&T's rate division earlier in his career (1409a).



-- agreement to conform -- is both a means and an end of the Bell System.

In sum, from all of these exchanges of communications, manpower manipulation, peer and hierarchical pressure, one minimum contract has to be: an agreement among the Bell System defendants to agree once the dust of debate and recommendations (or whatever euphemism you would use) has settled. To suggest that the Bell System is some sort of loose connection of companies that are free to follow their own inclinations on issues where AT&T has expressed a firm position is to deny reality. Defendants do not call themselves "The Bell Un-System." Indeed, the 1972 annual report of AT&T proclaims: "[T]he Bell System network is \*\*\* a single nationwide entity, each of its trillions of parts compatible with all the others" (E87).

PBX: nascent Centrex

The Bell System's system of consulting, meeting, agreeing on, and then implementing policy -- with AT&T describing the parameters of allowable variations -- worked with consummate grace in the creation of Centrex and its rate structure.

For many years prior to 1961, the Bell System defendants offered to business customers a service known as Private Branch Exchange ("PBX") service (109a). In its conventional

form, PBX allowed a customer to dial telephones within the customer's own premises and -- by dialing the digit 9 -- outside telephones; incoming calls were routed through a switchboard attendant to particular stations (419a-420a, 1177a). But twelve of the operating companies furnished to some PBX customers a feature that allowed for direct inward dialing ("DID"): outsiders could dial specific telephones of the customer without the intervention of the switchboard attendant (420a). Six of those twelve companies furnished to some PBX customers still another feature: identified outward dialing ("IOD"). With the aid of computers, the telephone companies could identify the station from which an outgoing call was dialed and would then show the customer the station charge on its monthly bill -- a very convenient administrative tool (111a, 420a-421a).

The monthly charges all over the Bell System for PBX service were calculated on the basic equipment used: (i) for each station, (ii) for the switching equipment located on the customer's premises and (iii) for the "trunks" that gave access to the telephone exchange (420a).

Genesis of Centrex: concerted action  
and uniformity sponsored by AT&T

In 1960, AT&T decided that the Bell System could greatly increase its profits if DID and IOD were extended nationwide. AT&T's rate division formed a Task Committee of



rate-makers from eight operating companies to work with AT&T representatives to develop basic principles and procedures for the expansion and marketing of IOD and DID -- under the name of "Centrex" (E102-E112).

The Task Committee focused on what rate structure would best preserve the Bell System's investment in PBX switching equipment and increase the rate of return on that equipment, while allowing the defendants to phase in newer equipment (E102-E201, E210-E267). Then it formulated "basic principles and procedures which it would seem feasible for all companies to follow in establishing rate treatment for Centrex Service" (135a; E102). Not only was the name for extended PBX with DID and IOD to be different, but the method of pricing was to be different. Instead of charging separately for each item of equipment, the operating companies were advised to make a single charge for Centrex, "packaging" into the station rate<sup>5</sup> all charges for equipment used (E102-E112).

5. While all Centrex systems had the capability of DID and IOD, there were two different physical arrangements for the service. With "Centrex-CU," the switching equipment was placed on the customer's premises. With "Centrex-CO," the switching equipment was on the telephone company's premises, and generally was a more advanced type; a pair of copper wires connected each station to the central office. Apart from the location and type of the switching equipment there was this important difference in the IOD capability provided with Centrex-CU and Centrex-CO. With Centrex-CO the station number could be automatically recorded on outgoing calls ("Automatic Number

(Footnote continued on following page)

In early 1961, AT&T sent out a comprehensive marketing and rate plan for Centrex in materials that it mailed out to the operating companies (E102-E112). Each of them knew from the face of the forwarding letter that the materials had been sent to each of the other operating companies (E102-E104).

AT&T stressed in these 1961 materials the importance of the "package" charge in the rate structure, and stated that "uniformity of rate approach" for Centrex service within the Bell System was of "unusual importance" (E103). Indeed, AT&T said that one of the "principal rate objectives" was to "[f]oster Systemwide uniformity of rate approach within all practicable limits" (E106). AT&T also underscored the desirability for uniformity in the other main elements of the plan (E102-E104).

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(Footnote continued from preceding page)

Identification," or "ANI"). However, for many years with Centrex-CU, a more cumbersome process was required; the number had to be orally stated to a telephone company operator, who in turn recorded this information ("Centralized Automatic Message Accounting," or "CAMA").

Although Centrex-CO was, thus, preferable for customers to Centrex-CU and -- due to the pair of copper wires connecting each station -- was more expensive to provide, AT&T urged that the two serving methods have essentially the same price. All agreed. With only the "recommended" inconsequential adjustment for the space and power consumed at the telephone company office with Centrex-CO, the per station charge for Centrex-CU and Centrex-CO was made the same; there was a composite or blended charge (421a, 1239a-1243a; E102-201, E280, E770-E771, E1203, E1755).



And the reason for AT&T's insistence on "uniformity" of rate approach was not left to the imagination of the operating companies' rate makers. Since Centrex promised to become the "standard" service "for our larger customers who have branch organizations scattered across the country," only by "uniform application of the principles and methods" described in the materials would rates in the various states be "sufficiently alike to seem reasonable" to these larger multi-state customers served by more than one operating company (E103, E105).

Uniformity of rate approach -- AT&T's 1961 materials thus told the rate makers in the Bell System -- would narrow price differentials between the operating companies in different states. Indeed, the materials included a series of model rates. AT&T stated its belief that "very similar rate treatment is entirely feasible and should be achieved" by "all the companies" (E103).

AT&T was not content to restrict the call for uniformity to officials in the operating companies concerned with rates. AT&T sent its 1961 Centrex materials to all the operating and marketing vice presidents of the companies as well. The covering letter, dated April 28, 1961, illustrates the quite overt peer and hierarchical pressure that requires agreement, combination and, yes, (if you will) conspiracy:

"I know you will be very much interested in the attached material we are sending to General Commercial Managers today to assist



in finalizing rate treatment for Centrex Service.

"As you will recognize, this material incorporates the principles we discussed at the Operating Conference in February. Recalling the general acceptance reflected there, it would seem that we can anticipate the consistent approach among the Companies which we all agreed was so vital in a basic service offering of this sort.

"It would be hard to overemphasize how important it is that all departments having anything to do with Centrex Service understand and act in conformity with the fundamental principles on which the rate treatment is based, as outlined in the attached material. You will no doubt wish to take a personal interest in seeing that this is accomplished." (E209).

AT&T still did not rest easy; the written word for uniformity to all concerned and to all that could bring pressure was not enough. AT&T called together the operating company rate officials "responsible for the development of the Centrex rates" for a two-day meeting to review the Centrex plan in May of 1961 (E268). The meeting's planners distributed forty AT&T charts (E269-E308) summarizing the previously mailed materials. Again emphasized was the need for the "package" rate and "systemwide uniformity of rate approach" (E269). Contemporaneous notes of the meeting by operating company representatives showed that "uniformity of rate approach" -- so that rates would be "close to each other" -- was the very "purpose of meeting" (E309-E329).



Centrex applied: AT&T goals achieved

Following the receipt of the AT&T materials the operating companies got up their rates and filed Centrex tariffs. By January 1, 1963, eighteen of the twenty-two operating companies then in operation had filed initial Centrex tariffs.<sup>6</sup> Every single one provided for DID, IOD and the "package" Centrex rate (422a-423a, 439a-444a). Only in nonessential particulars did the tariffs vary -- and only as contemplated and allowed by the AT&T materials.<sup>7</sup> The goal of uniformity on the basic rate objectives was achieved (439a-444a; 1301a-1305a).

6. Michigan Bell, which had a member on the Task Committee and thus had advance knowledge of AT&T thinking, filed the first "packaged" Centrex tariff on April 18, 1961, a few days before the mailing of the Centrex materials to the companies but well after an operating conference which explored these fundamentals. (1439a-1441a; E209, E459-E647).

7. Judge Weinfeld cited as evidence of independent action the undisputed facts that the rate levels for Centrex varied in the different service areas, as did the secondary features (those other than DID and IOD) provided by the operating companies. Nevertheless, his findings of fact support the only factual assertions made by plaintiffs concerning the initial Centrex tariffs of the defendant operating companies, from which the ultimate conclusion of an agreement may be drawn: each Bell System operating company established Centrex service (characterized, by definition, by DID and IOD); each established the package rate; none introduced variations that AT&T had not authorized; and -- where geographical and technological factors made possible the provision of both Centrex-CU and Centrex-CO -- each effectively reserved to itself the choice of serving method (161a, 422-423a, 439a-463a; E102-E201, E338-E359, E408-E730, E1573-E1653).

The Bell System's lobbying for  
and passage of the Reduction Act

In 1961, when Centrex came to be, a 10% federal communications excise tax on "general telephone service" had been in effect for some years (115a-116a). The tax was imposed on any telephone service permitting the customer to complete a call out of office through a local telephone company exchange (exchange access) and thus applied to PBX service. Since Centrex service (which was PBX with DID and IOD) permitted exchange access, it too became taxable as "general telephone service" (116a).

However, the Bell System tariffs in effect up to 1968 prohibited interoffice equipment furnished by a non-Bell company from being connected to the Bell network.<sup>8</sup> The non-Bell equipment did not, as a result, provide "general telephone service." This meant that the sellers of non-Bell inter-office equipment turned Bell's monopolizing weapon against it by pointing to a tax advantage to induce customers to buy non-Bell instruments for inter-office communications (1107a; E947-E948).

By 1964, AT&T decided to try to eliminate this selling point for its competitors, and began an extensive lobbying effort, which led by mid-1965 to the enactment of the provisions in the Reduction Act (683a-688a, 1335a-1336a; E874-E940).

8. See Use of the Carterfone Device in Message Toll Telephone Service, 13 F.C.C.2d 420 (1968).



Those provisions were based squarely on an AT&T draft ("Draft A") (E874-E883). Exempted from tax was "private communication service" for which "a separate charge is made." "Private communication service" was defined, as a service entitling the customer "to the use of an intercommunication system" for his stations regardless of whether the system "may be connected" to the local telephone exchange. 26 U.S.C. § 4252(d).

PBX customers immediately received the benefit of the exemption because the Bell System's PBX bills were based on separate charges for each individual piece of equipment; a "separate charge" could be identified for those items devoted to inter-office communication. But, since the charges for Centrex service were "packaged" into the station charge, there was no "separate charge" for inter-office communication, and the entire amount paid by the customer was taxable even after the passage of the Reduction Act. Only when the defendants separated their charges for the two elements of Centrex service -- private communication and exchange access -- would customers obtain the exemption extended them by the Congress. For the next 6 years, however, this separation was not to be made.

#### AT&T's decision not to unbundle

In late 1964, as AT&T lobbied for enactment of the Reduction Act, AT&T rate officials -- most particularly Robert D. Weber, who then had responsibility for Centrex rates -- began

to consider whether Centrex station charges should be unbundled so as to state a separate charge for "private communication service." Weber decided by mid-December of 1964 that the Centrex rates should not be separated, in large part because of his concern that any such change in the Centrex rates would subject the Centrex rates to regulatory review (827a-835a, 837a-842a, 848a-854a, 1374a-1378a, 1392a, 1394a, 1400a; E927-E931, E941-E942, E1408-E1409). And this was the decision of AT&T. Weber testified at his deposition:

"The reopening of the Centrex rates as a result of the proposed change such as this, would certainly permit any customer for whatever reason, even though unrelated to the problem here, to come forward and challenge the whole gamut of Centrex rates.

\* \* \*

"It was felt that any filing which would modify in any way existing Centrex rates might lead to questions by state regulatory commissions and perhaps more pervasive investigation into overall Centrex rates" (834a, 839a).

Until 1971, maintenance of the package rate continued to be the unequivocal position of Weber and of Robert M. Kemp, who took over Weber's Centrex function -- and, as a result, of AT&T; and, as a result, of the whole Bell System (848a, 1374a-1375a; E941-E946, E1282, E1290-E1291, E1751-E1752). AT&T's position was repeatedly communicated to the



Bell System operating companies and, until AT&T's position finally changed, not a single operating company separated its Centrex charges (423a-425a, 464a-466a, 962a-966a, 1278a-1279a, 1358a-1359a, 1401a; E979-E1120). To the contrary, five defendant operating companies, which filed initial Centrex tariffs after the Reduction Act's passage, first filed for package rates (422a-425a, 436a-444a, 464a-466a; E1288-E1289, E1308-E1309); this can only be explained by the Bell System's commitment to uniformity.<sup>9</sup>

In fact, in the fall of 1965 AT&T called a conference of Bell System personnel "responsible for the interpretation functions" in order to ensure that the operating companies would act "uniformly" with respect to the tax revisions in the Reduction Act (E989-E990). Representatives from every one of the operating companies attended at least one, of the two sessions, including people from the rate, accounting, commercial, treasury and legal departments (885a; E991-E1112). Despite the pleas of some of the operating company personnel at the conference that "if you change the tariff [to separate the

9. The District Court did not find otherwise. While accepting defendants' explanations for their failure to separate the package rate prior to 1971, Judge Weinfeld did not try to explain away the fact that five companies filed package rates after the excise tax implications had been understood. Clearly, the reasons cited by the District Court for the failure of other defendants to separate -- especially the burden of filing new tariffs -- did not apply to these five defendants. See 164a, n.76.

Centrex charges] it will make our job of selling easier," the AT&T rate people announced (i) that "pursuant to a top level decision," they "were adamant against making the required tariff filings" because "it was not desirable to reopen the matter to save the tax," and (ii) that "the tariffs would not be revised." (885a-892a, 899a-900a, 932a-934a, 1358a-1359a; E991-E1093, E1113-E1119, E1408)<sup>10</sup>

The operating companies' agreement not to unbundle (with some reluctance)

The operating companies abided by AT&T's "adamant" decision. Each operating company made substantial revisions in its books, methods, and procedures to comply with the Reduction Act but each continued to bill and collect tax on the entire Centrex charge. Not one operating company made a separate charge for inter-office communication (424a-425a, 436a-438a).

10. So intent was AT&T on "uniform" action by the operating companies under the Reduction Act that AT&T suggested at this 1965 conference that certain customers be charged for taxes they clearly need not have paid as matters then stood. In line with the original 1961 materials, Centrex was offered in most states by two different serving methods, Centrex-CU and Centrex-CO. To reflect the telephone company space and power used in Centrex-CO the Bell System defendants made a slightly higher charge for Centrex-CO than for Centrex-CU. See page 14, n. 5, above. AT&T "recommended" at the 1965 conference that the added Centrex-CO charge, even where it was separately stated by an operating company, should be treated as a charge for "telephone service" (taxable) and not for rent and power (not taxable), the ostensible purpose being "to maintain uniform treatment" with those Bell System operating companies "who have included the differential in a single [unbroken down] charge" (439a-444a, 947a-949a; E1113-E1119).



From time to time after the Reduction Act's effective date, customers asked that Centrex station charges be unbundled. Whenever an operating company official, in turn, raised the question with AT&T's Weber or Kemp -- for the operating companies did not handle these complaints independently, their responses were concerted by AT&T -- he was told that AT&T's position remained unchanged (962a-963a, 1401a; E1288-E1289, E1406-E1407).

For example, in January, 1967, Monsanto questioned Southwestern Bell about the federal excise tax on its Centrex service. Southwestern's man in charge, believing the matter "very difficult" to explain to the customer, consulted Weber of AT&T. Weber replied that AT&T had decided not to undertake any change in Centrex pricing structure purely to accommodate a customer tax advantage. Southwestern then told Monsanto that, after a thorough review of the matter with AT&T, Southwestern would make no change (498a-500a, 1362a-1363a, 1401a; E1273-E1287).

Union Carbide Corporation lodged a complaint with New York Telephone in 1966. One of New York Telephone's attorneys, Marion C. Mallory, prepared a draft response, which included a quotation from the Congressional report, to the effect that "Centrex systems" generally do not "as yet" provide for a separate charge and that "until" such a separation is made the

exemption will not apply to Centrex service. The draft was sent to Ernest R. Charvat of AT&T's General Tax Attorney's office, who consulted with Weber. At Weber's suggestion, the quotation was deleted, and Union Carbide learned simply that New York Telephone could not make the change in its tariff (497a-498a, 1401a-1403a; E1253-E1272).

Mobil Oil Corporation complained to New York Telephone about the tax on Centrex service in August of 1968. Mobil's letter of complaint also reached Mrs. Mallory, who wrote on the letter: "Talked to Mr. Charvat (AT&T) as to position of Bell System - Any chance of tariff change so that more advantageous tax treatment can apply - Mr. C. says no - tariff people aren't about to change. - Accting advised. M.C.M. 10/3/68." And so Mobil was advised that the tax on Centrex service must be collected (500a-501a; E1290-E1294).

In 1968, Owens-Corning Fiberglas Corp. asked Ohio Bell to separate the Centrex charges and, on meeting resistance, asked Ohio Bell to "make a formal request" to AT&T. Ohio Bell made the request. AT&T replied by sending a copy of New York Telephone's letter to Union Carbide Corporation to Ohio Bell's Division Sales Manager. AT&T wrote that the Sales Manager should give Owens-Corning the same opinion that New York Telephone gave to Union Carbide and tell Owens-Corning that "[i]t is clear from our investigation that there are no



plans in the Bell System" to separate the Centrex charges (501a-502a; E1295-E1307)."

AT&T's decision to unbundle Centrex charges  
and the operating companies' automatic agreement

By 1971, competitive conditions had changed for the Bell System defendants. In 1968, the Federal Communications Commission in the Carterfone case (13 F.C.C.2d 420 (1968)) struck down Bell System tariffs prohibiting the connection of non-Bell equipment to the telephone network. This decision meant that non-Bell manufacturers would, in time, be able to compete with the Bell Centrex service and provide DID and IOD. The inter-office communication service furnished by non-Bell equipment, since it would have a "separate charge," would not be subject to tax.

11. A large part of the District Court's opinion is devoted to AT&T's motive for not effecting a separation prior to 1971. Of central importance, Judge Weinfeld found -- as we had urged -- that a prime reason had been the desire to avoid regulatory review (152a). We suggested below that this desire to avoid regulatory review was, in turn, motivated by a recognition and concern that (i) Centrex rates may have been excessive in comparison to PBX rates, and (ii) Centrex-CU customers might have subsidized Centrex-CO customers. In fact, the evidence shows that AT&T's employees did recognize these problems, were concerned about them and therefore sought to avoid regulatory review. See page 21, above. The court below misconstrued our suggestion, first stating that plaintiffs contended that, in fact, Centrex rates were excessive and that there was discrimination between Centrex-CU and Centrex-CO and, second, finding that these contentions had not been proven (153a-156a). See page 73 n.22, below.

By January of 1971, several operating companies began complaining to AT&T that the "package" Centrex charge put them at a tax disadvantage in combating this competition (E1193-E1195, E1337-E1338, E1340, E1348-E1349). AT&T replied that it recognized this was a "system-wide problem" (E1339); but as late as May, AT&T told the operating companies that they should continue billing Centrex on the package basis while AT&T considered the matter (E1340). None of the operating companies stepped out of line and separated the Centrex charge while AT&T rate men cogitated. Some stuck to the commitment reluctantly. For example, an Illinois Bell official, when informed that AT&T wished Illinois Bell to continue to bill the package rate, made an internal plaintive note: "No relief here" (E1340).

However, in May of 1971 the National Office of the Internal Revenue Service ("IRS") ruled that certain accessory equipment used with Centrex was subject to tax (E1341-E1344, E1352-E1357). This threatened to increase the tax disadvantage to the bundled Centrex rate, a disadvantage that could be avoided entirely by separating the charge. Protests of the operating companies mounted; one company official noted the obvious for AT&T: the new tax "puts Bell System Centrex service at a decided competitive disadvantage to that of privately owned systems where taxed portions are easily separated" (E1345-E1348).



Still the operating companies did nothing until AT&T moved. But move AT&T did in June of 1971 and all the companies, which are now proclaimed to be independent decision-makers, followed like Pavlovian experimentees. An internal memorandum of the official in the AT&T comptroller's office who had responsibility for excise taxes pictures the true events that can be summarized as follows: (i) early demands for change and unbundling; (ii) a top-level AT&T "adamant" decision not to unbundle because reopening might cause problems with state regulatory bodies; (iii) a firm holding of the position for selfish reasons for six years; and (iv) a final relenting for equally selfish competitive reasons. We quote from the memorandum and cannot understand how the District Court ignored it (and it did just that):

"In 1965 we had Systemwide conferences with Legal, Commercial, Marketing, Rates and Tax Accounting people, at which it was pointed out that Centrex tariffs precluded our splitting out the so-called 'private communication service' element and treating it as non-taxable.

"The rate people, pursuant to a top level decision, were adamant against making the required tariff filings; the reason being given that the establishment of Centrex tariffs had been very difficult and it was not desirable to reopen the matter to save the tax.

"Our files show a number of examples in the years following where our rate people even objected to any statement that the matter was being considered. We did not even quote the Committee report because of certain wording

which indicated a change was contemplated (see underscoring in box).<sup>12</sup>

"However, after a number of complaints from the companies that they were suffering competitively because of the tax disadvantage created by our rate structure, work started about mid-1971 on a revised tariff wording" (E1408).

AT&T put its decision to separate in a letter sent to all the operating companies on September 27, 1971, "recommending" that the Centrex rates be broken out and giving them a method of doing so (E1374-E1392). The method was to identify a "trunk component (the equivalent of the taxed portion of PBX) of the overall Centrex station rate" and to express "it in the tariffs as a 'separate charge'" (E1378). Thus, although in Centrex-CO service there were no trunks and the switching facilities for both intercommunication and exchange access were on the Bell System company's premises and not the customer's, AT&T said that the operating companies were to assume the existence of trunks and base the separation on "the relationships used originally" in the 1961 AT&T materials. Centrex would then have two "separate" charges, one for exchange access (the trunks) and the other for intercommunication.

AT&T also advised that the companies were not to change the total rates for Centrex and salesmen were not to

<sup>12</sup>. The reference is to an article in Telephony magazine (E1409-E1410).



quote a "two component station rate" but only the "aggregate" charge. Furthermore, AT&T urged that it was "singularly important" that "the companies use a common method for unbundling" and that any company contemplating a different method submit it to AT&T for review (E1377, E1380-E1387).

The operating companies followed the lead of AT&T, as always, adopting the proposed methods or obtaining special dispensation from AT&T. AT&T assigned an official the task of "tracking" the operating companies to make sure they followed AT&T's "recommendation" letter -- "that is, go file it, restructure it and file it" (1052a-1053a).

By the end of 1971, five defendant operating companies had filed unbundled rates in at least one jurisdiction; and by the end of June, 1972, another fourteen had filed. Within one year of AT&T's September 27, 1971, "recommendation" letter, restructured rates had become effective in forty jurisdictions. By the end of 1972, all twenty-three defendant operating companies had filed tariffs unbundling the Centrex charges (464a-466a).

Short of some devil-may-care officer of some defendant throwing off the desire for organization promotion or security and testifying, yes, "we agreed, combined and conspired," is it possible to have better proof of agreement or combination or conspiracy to structure (read: "fix") prices?



The Bell System offers free choice, we submit, only in the sense that high-level policy makers debate whether to ring the decision bell; once the bell is rung, all must and do respond.

AT&T's rationale proved  
and our case proved

The unbundling of Centrex rates demonstrated why AT&T had been so insistent that all the operating companies maintain "uniformity" of Centrex charges. After the first unbundling of rates in the Fall of 1971, other Bell System operating companies received demands that they, too, unbundle. Some customers with Centrex installations in several states asked their Bell national account manager to put pressure on each defendant operating company with which the customer had a Centrex system to unbundle. Other customers made the demand directly to the operating companies (511a-514a; E1419-E1432).

In unbundling, the Bell system defendants simply filed their tariffs, something they could have done six years earlier or more and saved their customers from \$30 to \$50 million. That they acted out of self-interest and that they acted in combination and with an agreed-on united front was proved below; it was error for the District Court not to recognize the concerted action as a violation of the antitrust laws and a violation of a duty imposed by the Reduction Act.



STATUTES INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1, reads in relevant part:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."

Section 4251(a)(1) of the Internal Revenue Code, 26 U.S.C. § 4251(a)(1), as amended by the Excise Tax Reduction Act of 1965, 79 Stat. 145 (1965), reads:

"Except as provided in subsection (b), there is hereby imposed on amounts paid for the following communication services a tax equal to the percent of the amount so paid specified in paragraph (2):

Local telephone service.

Toll telephone service.

Teletypewriter exchange service.

The taxes imposed by this section shall be paid by the person paying for the services."

Section 4252(a) and (d) of the Internal Revenue Code, 26 U.S.C. § 4252(a), (d), read:

"(a) Local telephone service.-- For purposes of this subchapter, the term 'local telephone service' means--

(1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and

(2) any facility or service provided in connection with a service described in paragraph (1).

The term 'local telephone service' does not include any service which is a 'toll telephone service' or a 'private communication service' as defined in subsections (b) and (d).

. . . . .

(d) Private communication service.-- For purposes of this subchapter, the term 'private communication service' means--

(1) The communication service furnished to a subscriber which entitles the subscriber--

(A) to exclusive or priority use of any communication channel or groups of channels, or

(B) to the use of an intercommunication system for the subscriber's stations,

regardless of whether such channel, groups of channels, or intercommunication system may be connected through switching with a service described in subsection (a), (b), or (c),

(2) switching capacity, extension lines and stations, or other associated services which are provided in connection with, and are necessary or unique to the use of, channels or systems described in paragraph (1), and

(3) the channel mileage which connects a telephone station located outside a local telephone system area with a central office in such local telephone system,

except that such term does not include any communication service unless a separate charge is made for such service."



Section 6415 of the Internal Revenue Code, 26  
U.S.C. § 6415, read, at the time this action was commenced:

"Credits or refunds to persons who collected taxes. --

(a) Allowance of credits or refunds.  
-- Credit or refund of any overpayment of tax imposed by section 4251, 4261, or 4271 may be allowed to the person who collected the tax and paid it to the Secretary or his delegate if such person establishes, under such regulations as the Secretary or his delegate may prescribe, that he has repaid the amount of such tax to the person from whom he collected it, or obtains the consent of such person to the allowance of such credit or refund.

(b) Credit on returns.-- Any person entitled to a refund of tax imposed by section 4251, 4261, or 4271 paid, or collected and paid, to the Secretary or his delegate by him may, instead of filing a claim for refund, take credit therefor against taxes imposed by such section due upon any subsequent return.

(c) Refund of overcollections.-- In case any person required under Section 4251, 4261, or 4271 to collect any tax shall make an over-collection of such tax, such person shall, upon proper application, refund such overcollection to the person entitled thereto.

(d) Refund of taxable payment. -- Any person making a refund of any payment on which tax imposed by section 4251, 4261, or 4271 has been collected may repay therewith the amount of tax collected on such payment."

Section 7422(a) of the Internal Revenue Code, 26  
U.S.C. § 7422(a) reads as follows:

"Civil action for refund

(a) No suit prior to filing claim for refund.-- No suit or proceeding shall be

maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof."

Section 7422(f) of the Internal Revenue Code, 26

U.S.C. § 7422(f), reads in relevant part as follows:

" (f) Limitation on right of action for refund.--

(1) General rule.-- A suit or proceeding referred to in subsection (a) may be maintained only against the United States and not against any officer or employee of the United States (or former officer or employee) or his personal representative . . . .

(2) Misjoinder and change of venue.  
-- If a suit or proceeding brought in a United States district court against an officer or employee of the United States (or former officer or employee) or his personal representative is improperly brought solely by virtue of paragraph (1), the court shall order, upon such terms as are just, that the pleadings be amended to substitute the United States as a party for such officer or employee as of the time such action commenced, upon proper service of process on the United States . . . ."



## ARGUMENT

### Point 1

THE EVIDENCE, ALMOST ALL OF IT DOCUMENTARY, ESTABLISHED AN AGREEMENT, COMBINATION AND CONSPIRACY AMONG DEFENDANTS; THE DISTRICT COURT'S CONCLUSIONS TO THE CONTRARY ARE NOT SUBJECT TO THE INSULATION OF RULE 52(a) OF THE FEDERAL RULES OF CIVIL PROCEDURE; IN ANY EVENT THEY ARE CLEARLY ERRONEOUS.

The first ground for the District Court's decision to dismiss the antitrust claim -- that there was no agreement, combination or conspiracy among the Bell System defendants -- cannot stand. Short of confessions on the witness stand, the evidence of agreement, combination or conspiracy within the meaning of the antitrust laws could not be more conclusive. In finding against plaintiffs, the District Court lost sight of the standards that it gave in its opinion for evaluating evidence and ignored others that were urged upon it. It overlooked uncontroverted evidence of 23 operating companies of the Bell System -- instructed, guided and directed by AT&T at several meetings and through communications of all sorts -- moving in lockstep to establish the package Centrex rate, sticking to that tied-in rate despite economic and customer pressure to unbundle, and unbundling (again in lockstep) only when competition forced AT&T to change its attitude in 1971.

This Court can reverse without the constraints of the "clearly erroneous" rule because in this "paper case," where the live testimony played a minor part, the Court deals with the issue of conspiracy de novo. This is the teaching of the Supreme Court; it is a rule of this Court. But even if the Court were to be bound by the "clearly erroneous" standard of Rule 52(a) of the Federal Rules of Civil Procedure, it must conclude that the learned trial court was in fact "clearly erroneous."

We deal first with the standard of review and then proceed to set out the governing legal propositions. Next we revisit the background of these defendants and chart the evidence of agreement, combination or, if you will, conspiracy that requires reversal under those standards. Then, we will show that the evidence of conspiracy was not refuted by the evidence of independence that the District Court found persuasive. Indeed, we will show that, in final analysis, the District Court itself had to attribute AT&T's conduct to the other defendants to reach the result it did. Thus, the trial judge -- sub silentio -- denied the thesis of independence.

The District Court's conclusions  
are not shielded by the "clearly  
erroneous" test

The leading case on the question of the scope of review of the trial court's conclusions on whether a com-



bination or conspiracy existed and if so, whether it violated the Sherman Act, is United States v. General Motors Corp., 384 U.S. 127 (1966). It establishes that this Court is free to overturn the conclusion of no agreement, combination or conspiracy without being fettered by the "clearly erroneous" rule.

In General Motors, the Government charged the auto company and three associations of Chevrolet dealers in the Los Angeles area with participating in an alleged conspiracy to restrain trade by eliminating sales of new Chevrolets through discount houses. The District Court found, among other things, that a dealers' association had complained to General Motors personnel about sales to discounters; members of the association agreed to begin a letter-writing campaign to obtain General Motors' assistance in eliminating those sales; General Motors personnel talked with local dealers and obtained promises from them not to deal with discounters; representatives of the three dealer associations undertook to police the agreements obtained by General Motors and worked with General Motors in bringing wayward dealers into line; as a result, a number of dealers repurchased cars that they had sold to discounters and agreed to refrain from making those sales in the future. 384 U.S. at 140-41. In General Motors, as here, the District Court held "that the described events did not add up to a combination or conspiracy violative of the antitrust laws." Id.

The Supreme Court rejected the trial court's reasoning and reversed. It held that these findings "compel the conclusion that a conspiracy to restrain trade was proved." Here is the Court's discussion of the powers of appellate review (384 U.S. at 141 n.16):

"We note that, as in United States v. Parke, Davis & Co., 362 U.S. 29, 44-45, the ultimate conclusion by the trial judge, that the defendants' conduct did not constitute a combination or conspiracy in violation of the Sherman Act, is not to be shielded by the 'clearly erroneous' test embodied in Rule 52(a) of the Federal Rules of Civil Procedure. \*\*\* As in Parke Davis, supra, the question here is not one of 'fact,' but consists rather of the legal standard required to be applied to the undisputed facts of the case. See United States v. Singer Mfg. Co., 374 U.S. 174, 194, n.9; United States v. Mississippi Valley Co., 364 U.S. 520, 526, and cases there cited.

"Moreover, the trial court's customary opportunity to evaluate the demeanor and thus the credibility of the witnesses, which is the rationale behind Rule 52(a) (see United States v. Oregon State Med. Soc., 343 U.S. 326, 331-332), plays only a restricted role here. This was essentially a 'paper case.' It did not unfold by the testimony of 'live' witnesses. Of the 38 witnesses who gave testimony, only three appeared in person. The testimony of the other 35 witnesses was submitted either by affidavit, by deposition, or in the form of an agreed-upon narrative of testimony given in the earlier criminal proceeding before another judge. A vast number of documents were also introduced, and bear on the question for decision.

"In any event, we resort to the record not to contradict the trial court's findings of fact, as distinguished from its conclusory



'findings,' but to supplement the court's factual findings and to assist us in determining whether they support the court's ultimate legal conclusion that there was no conspiracy."

Thus, the Court held that the ultimate conclusions whether defendants had conspired and whether the conspiracy violated the Sherman Act were not "findings of fact" shielded from de novo review by Rule 52(a). And, the Court held that the deference to be accorded to the District Court's findings diminished in the presence of the "paper case."

The Court's analysis fits our case like a tailored suit. This too is very much a "paper case." Only four witnesses testified even briefly at trial, employees of only 3 of the 24 defendants. The great bulk of the record consisted of the 167 exhibits admitted into evidence, all but 12 from defendants' own files, the excerpts of ten depositions of defendants' officers and employees read by plaintiffs at trial, and the unusually extensive stipulations entered into by the parties. Against this record, the District Court's opportunity to evaluate demeanor plays the same extremely limited role here as it did in the General Motors case. The issue is really a question of law, "namely, whether the District Court applied the proper standard to essentially undisputed facts." See United States v. Parke, Davis & Co., 362 U.S. 29, 44-45 (1960)

and cases there cited.

Moreover, even were the District Court's conclusions to be the sort of findings that are subject to Rule 52(a), we submit that they are "clearly erroneous" as that test has been defined in the cases. The seminal case is United States v. United States Gypsum Co., 333 U.S. 364 (1948). The trial court found that the evidence failed "to establish that defendants associated themselves in a plan to blanket the industry under patent licenses and stabilize prices" and granted the defendants' motion to dismiss. The Supreme Court reversed. The Court held that to the extent the District Court's conclusions rested on a misapplication of the law, Rule 52(a) did not apply. On the other hand, to the extent the District Court's conclusions rested upon its assessment of the candor and credibility of witnesses, the conclusions were clearly erroneous. As the Court framed the test:

13. This Court has consistently applied the same rule in a variety of contexts. See, e.g., SEC v. Bausch & Lomb Inc., [Current] Fed. Sec. L.Rep (CCH) ¶96,186 at 92,351 (2d Cir. Sept. 30, 1977)(finding of "materiality" in securities case is not subject to FRCP 52(a)); Reyher v. Children's Television Work Shop, 533 F.2d 87, 90 (2d Cir.), cert. denied, 429 U.S. 980 (1976) (issue of "similarity" of two works is reviewable de novo); United States ex rel. Lasky v. LaVallee, 472 F.2d 960, 963 (2d Cir. 1973)(de novo review of whether petitioner had counsel is appropriate where issues turn on interpretation of documentary evidence); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849, n.11 (2d Cir.), cert. denied, sub nom. Coates v. SEC, 394 U.S. 976 (1969) (materiality is reviewable de novo); Donaldson Publishing Co. v. Bregman, Vocco & Conn, Inc., 375 F.2d 639, 641 (2d Cir. 1967), cert. denied, 389 U.S. 1036 (1968) (finding that person was "an employee for hire" is not subject to FRCP 52(a)).



"A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Id. at 395

The Court went on to review its reasons for rejecting the District Court's findings:

"The government relied very largely on documentary exhibits, and called as witnesses many of the authors of the documents. Both on direct and cross-examination counsel were permitted to phrase their questions in extremely leading form, so that the import of the witnesses' testimony was conflicting. On cross-examination most of the witnesses denied that they had acted in concert in securing patent licenses or that they had agreed to do the things which in fact were done. Where such testimony is in conflict with contemporaneous documents we can give it little weight, particularly when the crucial issues involve mixed questions of law and fact. Despite the opportunity of the trial court to appraise the credibility of the witnesses, we cannot under the circumstances of this case rule otherwise than that Finding 118 is clearly erroneous." Id. at 395-96; see also Orvis v. Higgins, 180 F.2d 537, 539-41 (2d Cir.), cert. denied, 340 U.S. 810 (1950).

Ours is a "paper case." However, to the extent that the District Court commented on the credibility of the four witnesses it heard, the Supreme Court's statement in the Gypsum case about the nature of the testimony and its lack of weight is squarely on point. With one exception, the testimony here actually supports plaintiffs rather than defendants. The ex-

ception involves testimony -- parroted by three of defendants' witnesses -- that there was no agreement among the defendants (1222a-1223a, 1356a-1357a, 1427a-1428a). That litany, consisting of responses to "extremely leading" questions, is "in conflict with contemporaneous documents" and therefore entitled to "little weight," particularly since "the crucial issues involve mixed questions of law and fact." United States v. United States Gypsum Co., supra, 333 U.S. at 396.

The principles that should govern, but did not below

The general legal principles applicable to finding an agreement, combination or conspiracy under the antitrust laws are not in doubt and the District Court mentioned some of them:

- Clearly, it is not necessary to show direct proof of an express agreement. E.g., Norfolk Monument Co. v. Woodlawn Memorial Gardens, Inc., 394 U.S. 700, 704 (1969); United States v. General Motors Corp., supra, 384 U.S. at 142-43; United States v. Parke, Davis & Co., supra, 362 U.S. at 44 (1960); United States v. Champion International Corp., 557 F.2d 1270, 1273 (9th Cir.), cert. denied, 46 U.S.L.W. 3215 (U.S. Oct. 3, 1977).
- "[A] finding of actual explicit agreement is unnecessary" (122a); there is no need for formalities. See, e.g., United States v. Masonite Corp., 316 U.S. 265, 275 (1942); Interstate



Circuit, Inc. v. United States, 306 U.S. 208, 226 (1939).

- "An inference of conspiracy can be drawn from the acts and conduct of the alleged conspirators" (122a): meetings, letters, memoranda, telephone calls, conferences, advice from on top and the like. See, e.g., Goldfarb v. Virginia State Bar, 421 U.S. 773, 781-82 (1975); United States v. General Motors Corp., supra, 384 U.S. at 133-34; United States v. United States Gypsum Co., supra, 333 U.S. at 372-86; Interstate Circuit, Inc. v. United States, supra, 306 U.S. at 215-18, 221-22.
- Consciously parallel behavior is itself circumstantial evidence of concerted action. See, e.g., Interstate Circuit, Inc. v. United States, supra, 306 U.S. at 221.
- Although, without more, conscious parallelism does not establish a conspiracy, Theatre Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537, 541 (1954), the additional quantum of proof required of plaintiffs in the presence of consciously parallel behavior is modest. See, e.g. Modern Home Institute, Inc. v. Hartford Accident & Indemnity Co., 513 F.2d 102, 110 (2d Cir. 1975); Overseas Motors, Inc. v. Import Motors, Ltd., 375 F. Supp. 499, 534-35 (E.D. Mich. 1974), aff'd, 519 F.2d 119 (6th Cir.), cert. denied, 423 U.S. 987 (1975). See generally, Turner, The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal, 75 Harv. L. Rev. 655, 658-59, 681 (1962).
- Concert f action, combination or conspiracy may be inferred "where the surrounding circumstances make it



unlikely that the parallelism of action was purely coincidental." See, e.g., Overseas Motors, Inc. v. Import Motors Ltd., supra, 375 F. Supp. at 535; see Bogosian v. Gulf Oil Corp., 561 F.2d 434, 446 (3d Cir. 1977).

- Duration of parallel action despite changing circumstances gives further proof of an agreement. Simple, one-time actions taken in common by several persons may logically be seen as coincidental. More complex uniform actions or actions maintained over a period of time make irresistible the inference of a concert of action. United States v. United States Gypsum Co., supra; American Tobacco Co. v. United States, 328 U.S. 781 (1946); United States v. Masonite Corp., supra.
- Parallel action against economic self interest is particularly convincing. See, e.g., First National Bank v. Cities Service Co., 391 U.S. 253, 279-80 (1968); Modern Home Institute, Inc. v. Hartford Accident & Indemnity Co., supra, 513 F.2d at 111; Milgram v. Loew's, Inc., 192 F.2d 579, 583 (3d Cir. 1951), cert. denied, 343 U.S. 929 (1952).
- Any arrangement, express or implied, substituting collective or central decision-making for independent action is a form of combination, conspiracy or concert of action within the Sherman Act. See United States v. Masonite Corp., supra, 316 U.S. at 276 ("[t]he fixing of prices by one member of a group, pursuant to express delegation, acquiescence, or understanding, is just as illegal as the fixing of prices by direct, joint action").



### The rules applied

Had the District Court considered those principles and applied them in the slightest degree, it could not have found against agreement, combination or conspiracy. <sup>14</sup> Our uncontroverted evidence, from documents and testimony binding upon defendants, established that there were meetings (concerted actions by definition), collective action taken pursuant to recommendations over years, urgings, peer pressures and pressures from above, knowledge among all defendants of what

14. In arriving at his conclusion of no agreement, Judge Weinfeld did not marshal the evidence with respect to each of the 24 defendants; rather, he used an "all or nothing" approach. While, as shown below, the evidence conclusively established an agreement among all the defendants, the evidence as to several leaves absolutely no room for doubt. For example, the three representative plaintiffs below were customers of New York Telephone and Southwestern Bell. The evidence -- undisputed -- shows the following: (i) both New York Telephone and Southwestern Bell were represented on the Task Committee which developed and agreed on the fundamentals of Centrex (1244a); (ii) both filed Centrex tariffs incorporating these fundamentals, including the package rate, the provision of both Centrex-CO and Centrex-CU with a composite rate, and the effective reservation to the telephone company of the choice of serving method (441a, 443a, 1482a-1483a); (iii) each received AT&T's 1965 memoranda on the Reduction Act and each was represented at the 1965 conference (492a-493a, 885a); (iv) between 1965 and 1971, each received requests from customers to separate their Centrex rates -- Monsanto, Union Carbide and Mobil -- and each consulted with AT&T (497a-501a; 1362a-1363a, 1401a-1403a; E1253-E1294); (v) in view of AT&T's adamant position, each refused to separate their Centrex charges, despite their customers' complaints (E1253-E1294); (vi) even though Southwestern Bell advised AT&T in early 1971 about increasing competition for Centrex and claimed to have begun to consider a way to separate Centrex rates, neither company actually separated until AT&T so "recommended," but both did so soon after AT&T's "recommendation" (465a-466a; E1193-E1194); and (vii) each effectively followed AT&T's proposed methodology for separation (424a; E1573-E1653).



the other defendants were doing and so on down the line. We give a summary chart of the key events that put our case well within the demands of the principles that guide decision; indeed, we submit, they put us well into the realm of conclusive proof that the District Court, in final analysis, demanded of us (see 156a-165a):

AT&T "initiative"

1960: AT&T decides to extend DID and IOD to all service areas; creates Task Committee of operating company rate-makers to work with AT&T in establishing fundamentals to be agreed to by all.

1961-1965: (i) AT&T "recommends" to all operating companies the establishment of Centrex, urging uniformity of rate structure, especially the package rate; AT&T sends extensive written materials to each, and holds conference, attended by each, to stress uniformity.

(ii) AT&T, while lobbying for the Reduction Act, determines that Centrex rates should not be unbundled. In 1965 AT&T communicates its "adamant" position against separation to all operating companies in memoranda and at 1965 conferences.

Conditioned response

1960-61: Eight operating companies serve on Task Committee, agree to and adopt fundamentals.

(i) All establish Centrex, with package rate, over the next few years.

(ii) No operating company unbundles. Although some express, at the 1965 conferences (a gathering of operating company personnel with AT&T departmental representatives), preference to do so because "it will make our job of selling easier" (885a-892a, 899a-900a, 932a-934a, 1358a-1359a), all yield to the need for collective action. Thus at least some defendants act against their own self-interest.

(iii) Even the five companies filing initial Centrex



AT&T "initiative"

1965-71: AT&T reaffirms its position against unbundling.

1971-72: Reacting to emerging competition, AT&T urges unbundling in 1971, sends proposed method for unbundling to operating companies and appoints people to watch over the process.

Conditioned response

tariffs after the Reduction Act's passage adopt the package rate.

No operating company unbundles. Customer requests to particular defendant operating companies to unbundle are not dealt with independently. Each operating company involved refers the matter to AT&T and follows AT&T's directives.

None unbundle until AT&T so directs; then all unbundle, adhering to AT&T's method or obtaining AT&T's approval of an alternative.

This well orchestrated pattern of behavior is underlain by a sort of basso continuo -- the numerous ties that bind defendants -- which we need not replay here. Linked by stock ownership, by policy directives, by personnel shuffles from company to company, by license agreements and a host of other factors, defendants can hardly be termed a loose confederation free to follow or reject AT&T's "advice" at will. The notion that each company exercised independent business judgment and concluded that it should not separate Centrex rates denies the real world of business organization.

To suggest that this is a case of mere conscious

parallelism (123a, nn. 34-35) is to be utterly mistaken -- to be "clearly erroneous."

The inference of conspiracy  
was not refuted by proof of  
independent action

Against all this, the District Court found that the defendant operating companies exercised "independent judgment" in connection with their Centrex rates and had "legitimate business reasons" for not separating those rates (163a-165a). Compare United States v. General Motors Corp., supra, 384 U.S. at 142-43. The several factors cited by the lower court by no means establish independent judgment; to the contrary, each factor -- when placed in its full factual context -- only reinforces the pervasive AT&T control over the defendant operating companies.

In a Section 1 case, it is not unusual for each defendant to submit detailed evidence to show that it was not a participant in a conspiracy but instead exercised independent judgment. See, e.g., Theatre Enterprises Inc. v. Paramount Film Dist. Co., 201 F.2d 306, 309-10 (4th Cir. 1953), aff'd, 346 U.S. 537 (1954); Michelman v. Clark-Schwebel Fiber Glass Corp., 534 F.2d 1036 (2d Cir.), cert. denied, 429 U.S. 885 (1976); Modern Home Institute, Inc. v. Hartford Accident and Indemnity Co., supra.

Modern Home Institute and Michelman illustrate, in



finding independence, the character of evidence required to defeat the inference of conspiracy otherwise to be drawn from consciously parallel behavior. In those cases, each defendant had provided a who-what-when-why-and-how guide to its decision-making process; proof was offered showing how each reached the challenged decision, under what circumstances, by whom it was made, and the business reasons underlying it. Each defendant provided its unique procedures and considerations, showing inter alia that each had acted without significant consultation with its co-defendants.

By contrast, defendants here have produced not a stitch of evidence of independent consideration or review by the defendant operating companies of the question whether to separate; indeed, all the proof went the other way. Witnesses for only two of the twenty-three defendant operating companies testified. The failure to produce witnesses for the other twenty-one defendants necessarily suggests that such testimony, if given, would have been unfavorable to defendants. See Interstate Circuit, Inc. v. United States, supra, 306 U.S. at 226. Even the two defendant operating company witnesses who were called shed no light on how, when or why their companies decided not to separate; neither participated in reaching the decision.

In the absence of direct evidence of independent consideration by the defendant operating companies on the

central question of whether to unbundle Centrex, the District Court looked instead to purportedly independent action taken on "related" decisions. None of the examples reviewed by the lower court shows independence. And the District Court's focus on these isolated threads ignores the larger scheme.

For example, the District Court cited the testimony of Arthur X. Ichter, an employee of Bell of Pennsylvania's rate department, who stated at one point that "he independently decided that Bell of Pennsylvania and Diamond State Telephone Company, for which he also did rate work, should establish separate charges before he learned that AT&T was considering the same step" (l63a). To be balanced against this claim of independent decision by him -- even if fully accepted -- are these undisputed facts. He did not make the final decision for either operating company (El361). Before even recommending a separation to his superiors, Mr. Ichter met with Robert M. Kemp at AT&T -- for whom Ichter previously had worked (l474a) -- to present his proposal and to obtain in Ichter's own words "clearance to file our proposed Centrex revisions" (El361). By then, according to Kemp's own direct testimony, AT&T had decided in favor of separation (l223a-l224a). Ichter was advised that AT&T was going to effect the separation system-wide; and it was only with this knowledge and AT&T's "clearance" that Ichter recommended to those above him that the separation be made (El361). Bell of Pennsylvania and Diamond



State did not, in fact, unbundle until after AT&T's letter of recommendation had been drafted and had been -- or was about to be -- distributed to each of the other defendants (464a; <sup>15</sup> E1364-E1367).

The District Court also cited as evidence of independence the fact that "[s]everal other operating companies began work on establishing separate charges before receiving AT&T's recommendations." But "beginning work" and actually separating the Centrex rates have different qualities: vagueness vs. definiteness. By 1971, a change in AT&T's attitude was in the wind. In early 1971, several defendant operating companies advised AT&T of the impact of the federal excise tax on newly emerging competition with Centrex and urged anew that a separation be made (E1193-E1195, E1337-E1338, E1340, E1348-E1349). AT&T replied that it was aware of a "system-wide problem" (E1339). But as late as May 1971, when an officer of Illinois Bell sought permission from AT&T to separate, he was rebuffed and noted plaintively on an internal memorandum, "No

15. Mr. Ichter's profession of "independence" is somewhat ironic in view of the history of his companies' Centrex filings. Bell of Pennsylvania and Diamond State filed initial Centrex tariffs only after the Reduction Act had passed, but nevertheless used the package rate. Contemporaneous documents make clear that the package rate was first adopted at that late date only because of AT&T's position (E1308-E1309). Had "independence" been a reality, separate charges would have been included in these initial Centrex filings. Mr. Ichter could not speak to this subject; he was not with these companies when their initial tariffs were filed (1474a).

relief here" (E1340). Definite fact: no one moved outside the Bell world until the apex company decided they all should.

In sum, the operating companies yielded to AT&T's "adamant" position one way until a forceful decision was put the other way. To grasp at some small and supposed "beginnings" instead of the true "endings" give an unacceptable picture of what really happened. It has nothing to do with true independence.

Similarly, that some of the defendant operating companies, in effecting the separation upon AT&T's urging, may have varied from the exact proposed method for separation provides no support for finding independent judgment on the question whether to separate. Moreover, no company varying from the norm of the details did so without prior clearance from AT&T (1052a-1057a 1428a-1430a; E1361, E1377). Rather than independence, the full record once again reveals an  
16  
agreement.

16. The District Court also pointed to variations in the initial Centrex filings as further evidence of independence. As we have shown, the initial Centrex tariffs of all defendant operating companies -- even those who first filed after the Reduction Act's passage -- included the essential elements stressed by AT&T, particularly the package rate. It should be noted that the force of the lower court's finding that Michigan Bell filed its initial Centrex tariffs before receipt of AT&T's final guidelines in April, 1961 is entirely removed by the court's acknowledgment that employees of Michigan Bell served on the Bell System task force which helped develop those guidelines (160a). Michigan Bell, thus, had notice of the fundamentals to be urged by AT&T months in advance of other defendants.



The trial court's ultimate need to attribute AT&T's reasons to all: a denial of the independence thesis

Finally, the "business" reasons put forward by the District Court, drawing largely on the testimony of AT&T's Kemp and Weber, as possible grounds for not separating are similarly useless as evidence of independent decision-making (See pages 73-76, below). That the trial judge used them to excuse all Bell System defendants is, in fact, a silent refutation of the independence claim. There is no evidence that each -- or even any -- operating company in the Bell System ever considered Kemp and Weber's "business reasons" during any relevant period.<sup>17</sup> In this testimonial vacuum, the court simply attributed the reasons claimed for AT&T's position on separation to each of the defendant operating companies (163a-164a). This attribution is unacknowledged acceptance of reality -- when it came to Centrex rate structure, the operating companies looked to AT&T for direction, and followed its directions.

Fairly viewed, the evidence overwhelmingly establishes defendants' combination and concert of action. The "definite and firm conviction," which the "entire evidence" and common sense leave, is that the Bell System functioned with high precision, wrought from agreement, in bundling Centrex rates and in their unbundling; the compelling judgment is that the District Court was wrong.

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17. Only 2 of the 23 operating companies produced a trial witness, and none put on the stand any officer who actually considered whether to unbundle prior to 1971.

POINT 2

DEFENDANTS' AGREEMENT, COMBINATION OR CONSPIRACY TO PRESERVE THE STRUCTURE OF THEIR CENTREX RATES VIOLATED SECTION 1 OF THE SHERMAN ACT: (i) IT WAS A PER SE VIOLATION BECAUSE IT WAS CONCERTED ACTION TO FIX PRICES; (ii) AT THE VERY LEAST, IT WAS AN UNREASONABLE RESTRAINT OF TRADE BECAUSE IT WAS ANTICOMPETITIVE, CANNOT BE JUSTIFIED EXCEPT FOR SELFISH REASONS AND CAUSED THE CLASS \$30,000,000 TO \$50,000,000 OF UNWARRANTED DAMAGE.

The Bell System defendants agreed, combined and conspired to structure the Centrex rates and to keep those rates intact. That was price fixing -- a means to charge the public more than it might have had to pay if there were no such agreement, combination or conspiracy. It is, therefore, a per se violation of Section 1 of the Sherman Act. Even if it were not a per se violation, the agreement, combination or conspiracy was an unreasonable restraint of trade or commerce, for it was done with a selfish purpose, conferred no benefits on any one but the Bell System defendants and damaged their customers, plaintiffs here.

The District Court, in finding that there was no illegality, gave reasons that do not withstand analysis or that lack support in the case law. The factual conclusions upon which it rested some of these legal points are contradicted by its own findings, are clearly erroneous or are irrelevant to the legal tests.



We show, first, that this is a price-fixing case and defendants are guilty of a per se violation of Section 1 of the Sherman Act. Then we show that, even if it were not per se bad, defendants' conduct must be viewed as an unreasonable restraint of trade in violation of Section 1.

Price fixing: a per se violation

We begin with the proposition that if the Bell System defendants' conduct is to be characterized as price fixing then they are guilty of a per se violation of the Sherman Act; there is no defense of reasonable justification or question of what motivated them. See, e.g., Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951) (agreement between parent and subsidiary to fix whiskey prices); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940) United States v. Trenton Potteries Co., 273 U.S. 392 (1927); Addyston Pipe & Steel Co. v. United States 175 U.S. 211 (1899); United States v. Joint-Traffic Ass'n., 171 U.S. 505 (1898).

Price fixing is not confined to the situation where people agree to set a specific price for their goods; it involves any concerted action that would artificially prevent the market or normal forces from coming into play on price levels; and it encompasses any concerted activity that would have "the effect of raising, depressing, fixing, pegging or stabilizing the price of a commodity\*\*\*\*" United States v. Socony-Vacuum

Oil Co., supra, 310 U.S. at 223; United States v. Container Corp. of America, 393 U.S. 333 (1969); United States v. General Motors Corp., supra, 384 U.S. at 147-48; National Macaroni Manufacturers Ass'n. v. F.T.C., 345 F.2d 421 (7th Cir. 1965); Plymouth Dealers' Ass'n v. United States, 279 F.2d. 128 (9th Cir. 1960); United States v. Gasoline Retailers Ass'n, Inc., 285 F.2d 688 (7th Cir. 1961); United States v. United Liquors Corp., 149 F. Supp. 609 (W.D. Pa. 1956), aff'd per curiam, 352 U.S. 991 (1957).

The question in all these cases is whether the particular offending device hit upon by the defendants is sufficiently related to price. The Supreme Court has refused to set exact bounds on the definition of price-fixing because the means of affecting price are as varied as fertile minds can make them. See United States v. Socony-Vacuum Oil Co., supra, 310 U.S. at 222-24.

Setting a price structure -- refusing to isolate elements in a package charge -- surely is price rigging of a rather blatant order; there is nothing subtle about it; and it can and does have the effect, at the very least, of helping to stabilize, or to prevent erosion of, prices. It can be a rather pernicious tool to mulct the public. There is no question that it interferes with the free flow of market forces; and there is no question that the structuring that was done



here aimed to block the natural course of tariff hearings that could have led to lower rates.

The District Court rejected this price-fixing concept on two stated grounds, the first of which has nothing to do with the character of price fixing.

First, it found that the relationship among defendants -- their "federal system" and "affiliation in a nationwide telephone system" -- "distinguishes" our case from those of price fixing "among independent competitors." The court's objection seems to come down to the proposition that there can be no price-fixing violation (i) among related companies or (ii) among companies which actually do not compete for the same customers. While the result was firm, the words of the trial court are rather hesitant: it uses "distinguishes" and "militates against" rather than "prevents" or "prohibits". Compare 134a & n.50 with 168a and 175a.

Second, the trial court found that the agreements here -- if any -- did not restrict the operating companies' freedom to set a price, only their freedom to change the Centrex rate structure; thus, the court said we do not deal with a form of price fixing.

Both of these points are contradicted by the case law and, we submit, logic.



On the first point: as the District Court recognized at an earlier place in its opinion, parents can conspire with subsidiaries and affiliates, and subsidiaries and affiliates of the same parent can conspire among themselves.<sup>18</sup> See, e.g., Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 141-42 (1968); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., supra, 340 U.S. at 215; T.V. Signal Co. v. American Telephone & Telegraph Co., 462 F.2d 1256, 1260 (8th Cir. 1972). These cases do not support the view that a relaxed standard should be used to test defendants' conduct. Logically and fairly, if defendants choose separate entities to conduct their business and to restrict their liabilities (including those in tort), they must suffer the consequences. The one case cited by the trial court for its proposition of relaxation of the norm, United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86 (1975), repeats and reaffirms the general principles that govern here:

"The central message of the Sherman Act is that a business entity must find new customers and higher profits through internal expansion--that is, by competing successfully rather than by arranging treaties with its competitors. This Court has held that even commonly owned firms must compete against each other, if they hold themselves out as distinct entities. 'The corporate inter-relationships of the conspirators . . . are not determinative of the applicability of the Sherman Act.' United States v. Yellow Cab Co., 332 U.S. 213, 227. See also Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc. 340 U.S.

18. Judge Weinfeld wrote: "there is no doubt that defendants in this case are legally capable of conspiring" (132a).



211, 215; Timken Roller Bearing Co. v. United States, 341 U.S. 593, 598; Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 141-142. A fortiori, independently owned firms cannot escape competing merely by pretending to common ownership or control, for the pretense would simply perfect the cartel." 422 U.S. at 116-17.

The only reason the Supreme Court held that "those general principles [did] not dispose" of that case was that the facts presented an unusual anomaly: a bank has created de facto branches to overcome anticompetitive impediments to branch banking. Hence, the Court held that "[t]o characterize these relationships as an unreasonable restraint of trade is to forget that their whole purpose and effect were to defeat a restraint of trade," the anti-branching rule that amounted to an unlawful market division. Id at 118.

In any event, two of the defendants stand on a different footing. Cincinnati Bell and Southern New England are not AT&T subsidiaries. AT&T owns only approximately 26 percent of the stock of Cincinnati Bell and 18 percent of the stock of Southern New England. Even assuming, contrary to precedent, that AT&T could not conspire with its near wholly-owned subsidiaries, the agreement and conspiracy between (i) AT&T and its wholly-owned or near wholly-owned operating companies on the one hand and (ii) the two independent operating companies on the other is itself unlawful. Any such agreement plainly constitutes joint conduct under the Sherman Act.



As the trial court also said at an earlier stage of its opinion, there is no need that alleged antitrust violators under Section 1 of the Sherman Act be competitors (134a). See, e.g., Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 142 (1968); Albrecht v. Herald Co., supra, 390 U.S. at 150 n.6 (1968); Cromar Co. v. Nuclear Materials & Equip. Corp., 543 F.2d 501, 511-12 (3d Cir. 1976). Indeed to accept the contrary proposition would immunize all vertical conspiracies from Section 1 prosecution. The focus is, in the words of the statute, on whether there is a "restraint of trade" not on whether the agreement is among actual competitors for the same business -- although that fact may be relevant. Moreover, here the very statutory objective of eliminating anti-competitive devices -- doing away with artificial prices -- was defeated by the refusal to unbundle; and, in fact, plaintiffs and the class they represent measurably paid more for their telephone service than they should have.

On its second point: we agree with the court below that "to be considered price fixing the agreements must have restricted the operating companies' freedom to set price according to their own business judgment." See Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, supra. But it simply is not a fact that the group's decisions to bundle and then not to unbundle did not restrict price freedom. Of course, they did. The 1961 materials concerning Centrex declare that one purpose was to



avoid wide rate disparities among defendants because the large multistate customers who were Centrex targets would question them. See pages 15-16, above. And the 1965 decision to retain the package rate was intended to counter the usual "market" pattern: to keep the Bell System out of the regulating bodies' clutches. That there were variations in the rate levels does not change the fact that the agreement on the Centrex rate structure put limits on what prices would be charged; it does not change the fact that price stabilization was surely helped (or thought to be helped) by the agreement to retain the structure.

And there is just no requirement that a conspiracy set prices directly. It is the possible effect on prices that counts. See, e.g. United States v. Container Corp. of America, supra; United States v. General Motors Corp., supra, 384 U.S. at 147-48 (1966); United States v. Socony-Vacuum Oil Co., supra, 310 U.S. at 222-24.

The court's further belief that there was no proof that the conspiracy was needed to stabilize prices is entirely irrelevant to the question of liability. Whether the conspiracy succeeds in its objectives or produces unreasonable prices is not a test of whether a violation occurs; it is certainly not the test, as the cases we have cited make clear, of whether any particular form of concerted activity is illegal. See,



e.g. United States v. Trenton Potteries Co., supra, 273 U.S. at 397-98.

Of course, plaintiffs were damaged as a result of the conspiracy -- at minimum by paying taxes they did not have to pay. The conspiracy was successful in keeping Centrex away from rate commissions. The fact that defendants did not retain the taxes does not mean that they did not benefit from their actions.<sup>19</sup> But that question of gain is totally irrelevant to whether defendants' conduct is to be described as price-fixing. See Albrecht v. Herald Co., supra, 390 U.S. at 152 & n.8. Similarly, the fact that after the Bell System defendants decided to apply for separated rates there was no immediate change in Centrex rates is irrelevant to whether they had price-fixed earlier. Further, from the customers' vantage point there was a palpable change in rates -- the price paid was reduced by the amount of the tax on intercommunication.

The District Court's discussion of the purpose or motive of the alleged conspiracy has no bearing on the question of a per se violation of the antitrust laws. If there is price fixing, one does not have to look to motive or intent; for there simply is no question of justification or balancing good against bad results of the restraint. See, e.g., Northern Pac. Ry. v. U.S., 356 U.S. 1, 5 (1958); United States v.

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19. To the contrary, they did gain in several ways already described, among them by avoiding regulatory review.



Socony-Vacuum Oil Co., supra, 310 U.S. at 210-14; United States v. Trenton Potteries Co., supra, 273 U.S. at 397-98. In any event, the trial judge was simply wrong (as we shall show below in our discussion of an unreasonable restraint on trade), in ascribing only good and noble motives and purposes to defendants. It is plain error to deny defendants' own testimony that one of the motivating purposes was to protect "vulnerable" Centrex rates from regulatory scrutiny, a proposition confirmed by Bell System documents. See pages 68-76, below.

What defendants did do was to price fix, and in a not very ingenious or rare way.

An unreasonable restraint of trade proved

But even if this Court decides that the per se rule should not apply, it must hold that defendants agreed, combined and conspired to restrain trade unreasonably. The District Court's conclusions that the Bell System defendants' conduct was not anticompetitive, had no price-fixing motive and was all well intended are wrong on the undisputable facts and suffer also on the law.

We agree with the District Court that Mr. Justice Brandeis' formulation in Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918) remains the classic definition of the rule of reason:

"The true test of legality is whether the restraint imposed is such as merely



regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences."

Asking the questions posed by Mr. Justice Brandeis leads to answers that rebut defendants' claims of having acted reasonably. Their purpose was not to promote competition but the antithesis: to avoid erosion of their uniform Centrex rate structure and minimize possible challenges to their overall rate of return. If the purpose was thus anticompetitive, so too was the effect. Their concerted actions denied plaintiffs the benefit of the price reduction -- in the amount, at a minimum, of the excise tax on inter-office communication -- that would surely have followed had defendants pursued an independent course instead of bowing to AT&T's will.

Moreover, the conspiracy here is in at least three respects even more pernicious than those usually encountered and even less worthy of protection.



First, it was directed at state and local regulatory authorities as well as at customers, and was intended to undermine their rate-making activities -- their safeguarding of customers' interests -- by avoiding their review of Centrex rates.

Second, this conspiracy also had the effect of usurping a Congressionally enacted tax benefit for plaintiffs and converting it into a Bell System competitive weapon. AT&T lobbied for the Reduction Act on grounds that suggested the tax benefit would promptly be passed on to customers (see pages 80-84 below). Despite this, the defendants deliberately withheld the benefit of the Reduction Act's exemption until such time as the FCC authorized alternative suppliers of Centrex-type service to compete directly against the Bell System's service. Defendants' misuse of the Reduction Act as a weapon in their own competitive arsenal would tip any rule of reason analysis decisively against them.

Third, because defendants are monopolists -- a factor cited by the District Court to excuse them -- their concerted activities are of a sort deemed "unusually damaging" by the Supreme Court, for customers "could not turn to alternative sources for the necessary service." Goldfarb v. Virginia State Bar, 421 U.S. 773, 782 (1975).

Defendants' claims of  
reasonableness rebutted

The District Court concluded, despite these facts, that defendants' agreement did not violate the rule of reason. It gave several grounds, none sufficient.

First, the District Court found that any such agreement "limited the defendants' economic freedom only slightly" (174a). Quite apart from the fact that the evidence showed defendants' discretion was completely fettered as a result of AT&T's directives (see pages 21-25, above), the District Court's analysis fails to take into account customer interests. Defendants' agreement surely shackled customer choice. While, in the Court's view, defendants' economic freedom might not have been hampered, plaintiffs paid \$30 to \$50 million on account of that agreement.

Second, the District Court excused defendants because state regulatory commissions are empowered to "assure the fairness and reasonableness" of defendants' tariffs (174a). The Court recognized our claim -- borne out by the proof -- that defendants' conspiracy had been directed at state regulatory agencies but said that this contention rested on the unacceptable proposition that "the public agencies were derelict \*\*\*." (175a). We respectfully disagree. As common sense suggests and the evidence confirms, utility commissions,



frequently understaffed, typically react to tariffs submitted by defendants; tariff filing is the usual incident that triggers regulatory review. See, e.g., Cantor v. Detroit Edison Co., 428 U.S. 579, 592-95 (1976); see Competition in the Telecommunications Industry Hearing Before the Subcommittee on Communications of the House Committee on Interstate and Foreign Commerce, 94th Cong., 2d Sess. 1022 (1976) (Statement of Michael Darr Barnes, Member of the Maryland Public Service Commission). It was defendants who were derelict -- to the public -- by not giving the commissions the materials to act.

Third, the District Court repeated its conclusions that the affiliation among defendants and the alleged lack of competition between them precluded a finding that they had restrained competition. We have already dealt with those points. Suffice it to say here that the benefits of independence in form beget independence in duty; the antitrust focus under Section 1 is on restraint of trade and reduction of competition, not whether it is competitors who do the restraining (see pages 59-61 above).

Fourth, the District Court came to the issue of the purpose of the restraint and accepted defendants' proffered "business reasons": their belief that the tax would expire, their concern that the Internal Revenue Service might not accept their chosen method of separating Centrex tariffs



and their desire to save on the expense of unbundling. In accepting these reasons, the Court grounded its view on the belief that any agreement to separate the charges after the Reduction Act passed was not motivated by a desire to protect the rates from regulatory scrutiny.

But the major factual premise for the trial judge's conclusion is wholly at odds with the evidentiary facts found by the Court and with the admissions of defendants. Contrary to the lower Court's summary conclusion, its own critical finding establishes that the conspiracy was in fact motivated by a desire to avoid review. Here is the trial court's inconsistent finding:

"In addition, Kemp and Weber were concerned about the possibility of an expensive, time-consuming challenge before a regulatory commission if new rates were filed. When a telephone company proposes to change existing tariffs, the subscribers to the service in question constitute a ready-made body of potential intervenors who might protest to the regulatory commission. While it is true that a change in tariffs which had only the effect of lowering the excise tax would be unlikely to attract much opposition, the fact remains that the rate-making personnel in the operating companies and AT&T recognized the possibility that either subscribers or commissions might take the opportunity to attack the Centrex rate structure in general. While these officials did not consider that any attack on Centrex rates would be justified or have merit, nevertheless the expense of litigating such a challenge could greatly increase the costs of making the change,



and the ultimate outcome was uncertain."  
(147a-148a).

The testimony of Messrs. Kemp and Weber, who the District Court found credible and who were, as defendants' counsel argued, "at the heart and soul" of any conspiracy if there was one (1486a), provides the basis for this inconsistent finding and leaves no doubt as to the grounds for their decision not to allow the operating companies to separate.

Mr. Weber was "adamant" against filing new tariffs separating the package rate because establishment of the original Centrex tariffs had been difficult, "and it was not desirable to reopen the matter to save the tax" (E1408). He testified that he was concerned about a reopening because it would "permit any customer for whatever reason" to come forward and "challenge the whole gamut of Centrex rates" (834a). A reopening might lead to "more pervasive investigation into overall Centrex rates" by regulatory commissions (838a-839a).

Defendants' lead witness, Mr. Kemp, on cross examination, further confirmed what the contemporaneous documents, made without an eye to litigation, establish. Whenever a service had been in effect for some time, as Centrex had, he testified that there would be a body of customers constituting a "readymade" source of intervenors and objectors (1256a). He recognized as a possibility that they might have objected to

the Centrex rates if a separation of those rates had been made<sup>20</sup> in 1967 through 1971 (1256a-1257a). Even more important, he was concerned that, if such an unbundled tariff were filed, someone would come in and attack as too high the overall rates of return of the operating companies (1257-1258a). This was of particular concern because:

"[W]e were just coming off of about a ten-year period of show-cause orders as opposed to asking for general rate increases, and when you have been through a period like that, it is a little concern of yours. You just don't know whether the dust is settled." (1258a); Mr. Ichter was in accord (1472a).

Thus, both Kemp and Weber admitted that a factor in their decisions was the concern that company rates of return would be attacked. They confirmed the precise concern voiced at the 1965 conference, attended by all the defendants, that Centrex tariffs had been passed through all the various state commissions "with great difficulty and they would stand a great chance of losing the whole thing if they opened up that can of worms" (152a, 892a). These concerns go to the very heart of the pricing and rate setting process.

They were not idle or illusory concerns. For example, the charge of a "composite" average rate for Centrex-CU and Centrex-CO required the former to subsidize the latter.

20. Intervening customers would not protest that rates are too low, as the Court implied, but that rates are too high, as Mr. Kemp admitted (1257a).



As Kemp testified, this meant that Centrex service "would be very vulnerable to charges of cross-subsidization" (Tr. 730). Mr. Ichter agreed, in a memorandum written long before this<sup>21</sup> litigation (E400).

Another source of vulnerability lay in the fact that Centrex-CU service used equipment identical to the equipment used in the old PBX with DID and IOD (1237a; E1755), and yet the rates charged for Centrex-CU were substantially in excess of those for the identical PBX service (E122). One of the purposes of "initiating" Centrex was, by simply applying a different label, to get a hidden rate increase on PBX equipment so as to "improve overall Company return" without applying to the regulatory agencies for a rate increase (E151). And in fact the Centrex rates filed by the operating companies made it "a better-earning service" than PBX (E1202, E1241). Obviously, as defendants viewed the matter, it would be best not to invite regulatory commissions to poke around in Centrex

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21. The amount of the subsidy was actually greater than it appeared because, in developing their tariff rates, defendants inflated the cost of Centrex-CU to include the costs of providing ANI for purposes of calculating the composite Centrex-CO-CU rate (E160, 165). Since defendants by 1965 still had not provided ANI with Centrex-CU in most jurisdictions (this remained true at least as late as 1968 (E1196-E1240)), the CU customer was doubly disadvantaged -- while his service cost the telephone company less to provide and while his tariff was based in part on a service that he did not receive, he paid essentially the same amount as a customer receiving Centrex-CO.



rate structures.

The anticompetitive purpose of defendants' conspiracy is thus clear and outweighs the other "business reasons" for not unbundling accepted as true by the trial court. Surely these supposed reasons do not justify the imposition of a \$30 to \$50 million dollar penalty on plaintiffs. Nevertheless, lest the point go by default, we deal with them briefly here to show their insubstantiality.

Messrs. Kemp and Weber testified that they believed, during the years after passage of the Reduction Act, that the excise tax would expire within a few years. Hence, they felt it was not worth refiling the Centrex tariffs for the sake of an arguably short-lived tax savings (1224a, 1345a). The District Court, recognized our argument that "no knowledgeable person could have believed, in light of the government's need for revenue as a result of the Vietnam war, that the tax would be allowed to expire and, that AT&T's Washington lobbyists and

22. We emphasize that the issue here is not whether rates were in fact excessive or otherwise vulnerable to revision, any more than the issue as to whether there had been price fixing or restraint of trade by firms which are not public utilities would depend on whether prices were in fact pegged at an arbitrarily high level. It is enough that defendants feared market forces -- here regulatory action -- might reduce or erode the price structure and that they moved in concert to stifle such forces. United States v. General Motors Corp., *supra*; United States v. Socony-Vacuum Oil Co., *supra*, 310 U.S. at 220-22.



tax attorneys were aware of this" (148a), but still upheld the Kemp and Weber position. In effect, the Court held that Kemp's and Weber's supposed belief that the tax would expire insulated all defendants from liability, even though, as the record shows in abundant detail, AT&T's Washington office and entire executive command -- as well as anyone who could read a newspaper -- were well aware that Congress would not repeal the tax (1081a, 1084a-1085a, 1088a-1090a; E 965-E978) and even though AT&T's own documents and tax newsletters circulated within the Bell System during the years after 1965 expressed the view that the tax would "continue to be with us for some time in the future" (E1122).

The testified-to belief of Kemp and Weber cannot stand as a defense to the claims plaintiffs make here, and the District Court's conclusion cannot stand either. Otherwise, a corporate defendant could always excuse itself on the ground of sheer incompetence: as long as the left hand does not know what the right hand is doing there can be no liability.

Moreover, there is no testimony that the supposed decision-makers at the operating company level shared the claimed ignorance of Kemp and Weber.

As to the concern over a possible IRS challenge to the method of separation: if this in fact were a "reason" for their not unbundling, presumably defendants would have sought



a ruling on the matter before taking action in 1971. The evidence makes clear no such ruling was asked for (1296a-1297a; E1406-E1407).

As to time and administrative expense, the subject of much of Mr. Kemp's direct testimony, no matter when the separation was made, it would have entailed some administrative work by defendants. The time and administrative trouble were undoubtedly higher in 1971 (when defendants separated to serve their own purposes) than they would have been in 1965 when defendants could have made the minor, non-controversial changes as a part of the very substantial work required to comply with other parts of the Reduction Act (1289a-1292a; E1120). No added special expense was incurred by defendants to effect the separation; it was simply performed by the concerned departments and was absorbed in general overhead (1292a-1295a). And the time and expense proved insubstantial to defendants in 1971 when their competitive needs outweighed the other risks (464a-466a; 1289a-1290a). Minor stuff, this expense claim, at best.

So much for the purported business rationales for defendants' conduct. They are outbalanced, selfish and, we submit, either insubstantial or untrue.



### Conclusion

In sum, the evidence conclusively establishes that (i) defendants combined, conspired and acted in concert to maintain the package Centrex rate structure; (ii) their purpose was at least in part to avoid regulatory and customer review of Centrex rates and of defendants' overall rates of return; (iii) they feared that an independent decision by any defendant operating company to follow its economic self-interest would have inexorably led to customer pressure to unpackage Centrex rates in other jurisdictions and a chain reaction triggering regulatory review in all jurisdictions; and (iv) the effect was to inflate the price plaintiffs paid for Centrex service. We submit that these actions violated Section 1 of the Sherman Act: either per se or as an unreasonable restraint of trade.



Point 3

THE EXCISE TAX REDUCTION ACT OF 1965 REQUIRED DEFENDANTS TO MAKE A SEPARATE CHARGE FOR CENTREX SERVICE WITHIN A REASONABLE TIME; DEFENDANTS BREACHED THIS DUTY TO THEIR CUSTOMERS: (i) CONGRESS SURELY DID NOT INTEND TO GIVE THE BELL SYSTEM DEFENDANTS UNFETTERED CONTROL OF WHETHER AND WHEN MANY MILLIONS OF DOLLARS OF EXCISE TAXES WOULD BE DUE AND (ii) A CONSTRUCTION OF THE STATUTE THAT WOULD GIVE THEM THAT KIND OF CONTROL RAISES A SERIOUS CONSTITUTIONAL ISSUE THAT IS TO BE AVOIDED.

A summary of  
the argument

The Reduction Act required that the Bell System defendants establish a separate charge for Centrex service within a reasonable time after the Congress passed it. For this Court to adopt any other interpretation, it would have to find that Congress intended to give self-interested defendants unguided power to control (i) whether the United States Government would or would not receive many millions of dollars in excise taxes, and (ii) whether the plaintiffs would or would not have to pay those many millions of dollars. But that was not Congress' intent. The obvious expectation of the Congress, and, therefore, its intent, was that Centrex charges would be unbundled in short order and that plaintiffs would be left with these dollars. To read the statute as giving defendants an unrestricted license on when and if to tax their customers does more than batter Congressional intent. It presents the



very serious constitutional question of an unguided and, therefore, improper delegation of the taxing power. The rule of interpreting statutes to avoid such issues then comes into play. The Supreme Court has told us how to avoid the constitutional issue when the question is one of improper delegation: a requirement of reasonable standards and reading the statute to impose a restraining duty.

Thus, both intent and a rule of construction coalesce. The Bell System defendants had a duty to unbundle Centrex charges with reasonable speed, and they violated that duty in naked self-interest.

Legislative intent:  
hardly one of unbridled  
license to defendants

Congress -- at the defendants' urgings -- wanted to exempt private communication systems (inter-office calls) from taxation. Undoubtedly, in creating this exemption, Congress accepted the notion that the administrative burden would be easier for the collecting telephone companies if the exemption applied only where "a separate charge is made for such service." 26 U.S.C. §4252(d). The question arises instantly from that scheme: Did the Congress intend to go beyond administrative ease to a delegation of power to the collector to say when and how much taxes are to be collected and from whom? And more questions arise: Was there no time limit on defendants to give



relief to their Centrex customers? Were potential taxpayers to be left to the fortuity of whether they got a broken out monthly bill that segregated the charges for inter-office communications?<sup>23</sup> In sum, the Reduction Act had built-in "ambiguities"<sup>24</sup> that require interpretation.

Answers appear. The Reduction Act's exemption language immediately suggests that the collecting defendants' power is "instinct" with some reasonable obligation. It is impossible to imagine that the Congress would knowingly grant these self-interested defendants the power to determine not only when, but if, their customers are to be taxed for millions

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23. This question of interpretation had to be solved in a ruling of the Internal Revenue Service, Rev. Rul. 69-152, 1969-1 Cum. Bull. 289. See discussion in Point 4, below, at 94 n.29.

24. Justice Frankfurter (then Professor Frankfurter) and Dean Landis spoke of the ubiquitous latent ambiguity of the tax laws this way:

"As to tax cases, it is plain that meaning and validity depend upon an elaborate exegesis of the legislative process which formulated the contested provisions. Revenue measures, it becomes relevant to remember, are the product of expert draftsmanship." Frankfurter and Landis, The Business of the Supreme Court, at October term, 1930, 45 Harv. L. Rev. 271, 302 (1931) (footnote omitted).



of dollars.<sup>25</sup> On the face, this statute suggests that there is legislative history that will give it meaning.

And that history does give the statute meaning. The legislative material is striking in the direct way that it pinpoints these defendants and the Centrex system; it is striking in putting before the Congress the expectation of the involved experts and Committees that these defendants would unbundle Centrex rates. The Reports of both the House and Senate Committees show that they expected that these particular defendants would take action. Both Reports noted that "as yet" there was no separate inter-office communication charge for Centrex (as opposed to PBX); they noted that the Reduction Act's exemption would not apply "until" that charge was created. H.R. Rep. No. 433, 89th Cong., 1st Sess. (1965), reprinted in [1965] U.S. Code Cong. & Ad. News 1645, 1677; S. Rep. No. 324, 89th Cong., 1st Sess. (1965), reprinted in [1965] U.S. Code Cong. & Ad. News 1690, 1725.

A little bit more delving into the legislative background establishes quite vividly that the drafters of this

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25. We have estimated that the class overpaid \$30 to \$50 million in the six years that the Bell System defendants would not act upon the Reduction Act's exemption. The defendants and the District Court have not defined their view of defendants' discretion -- could they have delayed even longer than six years? Suppose defendants' self-interest had kept the unbundled rate going for six more years; or ten; or thirty?



legislation -- those responsible for putting it into shape for the Congress -- had no intention of delegating to anyone the power to determine whether a taxpayer would pay excise taxes and that they meant to draft legislation that would not give away that power. Their expectation, which governs intent, had to be that Centrex charges would be broken out in short order. Not only were those responsible for the legislation not willing to confer upon defendants the authority to determine when the tax would fall due, but they were quite adamant in making sure that even state regulatory bodies would not control the taxable event.

AT&T lobbyists submitted a draft of what became the Reduction Act -- "Draft A" (E874-E883) -- to the Joint Congressional Committee on Internal Revenue Taxation in November of 1964. Defendants sought to relieve private communication service of the excise tax; and they gave every reason to believe that they would effect this removal, should their draft pass.

There were direct and continuous negotiations between the AT&T lobbyists and the staff of the Joint Committee. There is testimony in this record about those negotiations and, in particular, a meeting of November 9, 1964 between AT&T representatives and the staff members of the Joint Committee, including Dr. Laurence Woodworth, then Chief of Staff of the



Joint Committee and presently Assistant Secretary of the Treasury for Tax Policy.

26

Mr. Frank L. Fuller, AT&T's General Tax Attorney, testified in this case (his deposition was read into the

26. In the context of considering our claim of unreasonable restraint, Judge Weinfeld adopted, almost verbatim, an argument of our opponents that the court was not to consider "Draft A" and staff negotiations with AT&T's lobbyists as a guide to legislative intent. The theory was that there is no showing that Congress was aware of all the in-fighting that went on (145a-146a). But the universal rule is that in complex tax statutes, where technicality is the rule and where the drafting staff of a committee is widely respected for its expertise and professionalism (1103a-1104a), staff pronouncements and doings are to be accorded great weight. See, e.g., Federal Power Commission v. Memphis Light, Gas and Water Div., 411 U.S. 458, 471-72 (1973); Sims v. United States, 252 F.2d 434 (4th Cir. 1958), aff'd, 359 U.S. 108 (1959); Frankfurter and Landis, supra, n.24. Indeed, it was quite strange that defendants argued (and persuasively, as it turned out) to the District Court that it was not to look to the legislative history, "Draft A" and AT&T's negotiations with the staff of the Joint Congressional Committee on Internal Revenue Taxation: Their affiliate, Western Electric Co., took the very opposite view -- and again successfully -- before the Court of Claims in Western Electric Co. v. United States, Fed. Ex. Tax Rep. (CCH) ¶ 16,274 (Ct. Cl. Oct. 19, 1977). In that case, the Court of Claims was concerned about an interpretation of the Reduction Act and §4252(d). It analyzed at length "the negotiations between representatives of the American Telephone and Telegraph Company and the staff of the Joint Committee on the Internal Revenue Taxation Proceeding preceding passage of the act \*\*\*." (¶16,274 at 7731-32). The Court made extensive use of "Draft A" and a letter written to the Joint Committee by AT&T's general tax attorney Mr. Victor Ferrall (E932-E940).

The truth helps -- as it may hurt. The general rule is, and has to be, that the courts may look to any proceedings, hearings, or happenings, formal or informal, that may provide guidance to what was intended. See, e.g., Rosebud Sioux Tribe v. Kneip, 430 U.S. 584 (1977) (the Supreme Court looking to remarks of an inspector from the Indian Affairs Bureau at a meeting in 1901 of the Indian Council and at other meetings held on the reservation in 1903 in order to construe Congressional acts settling the boundary of an Indian reservation).



record) -- from his contemporaneous meeting notes (E893-E909) -- that Dr. Woodworth was insistent at that November 1964 meeting that the applicability of the excise tax was not to turn on the actions of state regulatory commissions:

"[Q.] Now, the next statement of Mr. Woodworth, which if I read it correctly, is, 'Real problem is that tax base could be changed by local regulatory action.'

"Can you tell us what that was about?"

"A. Yes. This is one thing that I remember a little more clearly than the other things."

"Mr. Woodworth was concerned that the federal tax base could be controlled by the actions of a state regulatory commission and he didn't like the idea."

"Q. Did he expand on that at all that you recall?"

"A. No, except that he thought that the base of a federal tax should not be within the control of a state action." (716a).

If the Joint Committee's chief drafter was concerned that state regulatory agencies not control the taxable incidents is it possible that he wanted it to rest on unregulated actions of the Bell System?

That the Congress thought it was delegating to defendants the unlimited say whether and when to tax its customers is, upon analysis, simply as absurd as our instincts would tell us. Defendants' proposition would have gotten very few, if



27  
any, votes.

Interpreting to avoid  
a serious constitutional  
issue

Apart from the fact that it cannot be seriously urged that Congress truly intended to give the Bell System uncontrolled taxing power, a rule of statutory construction forces us to impose a rule of reason on defendants under Section 4252(d) of the Reduction Act. This is "[t]he time-honored principle of construing a statute not only to escape unconstitutionality but to avoid 'grave and doubtful constitutional questions'." United States v. Jakobson, 325 F.2d 409, 415 (2d Cir. 1963) (Friendly, J.), aff'd sub nom. United States v. Seeger, 380 U.S. 163 (1965); see National Cable Television Association v. United States, 415 U.S. 336, 342 (1974); United States v. Thirty-Seven Photographs, 402 U.S. 363, 367 (1971); Lynch v. Overholser, 369 U.S. 705, 710-11 (1962); International Ass'n of Machinists v. Street, 367 U.S. 740, 749-50 (1961); United

27. We anticipate: Although defendants have rejected the appropriateness of the legislative background of the Reduction Act as an aid to its construction, they most assuredly will refer this Court to a December 17, 1964 letter from AT&T's general tax attorney to Dr. Woodworth, suggesting that defendants then had no plans to amend their Centrex tariffs (E932-E940). This, however, does not suggest that the Congressional staffers authorized any delay in giving Centrex customers the benefit of the tax exemption. To the contrary, following this letter, all references to "tariffs" were removed from the Reduction Act, permitting the unbundling to be made by a bookkeeping allocation.



States v. Rumely, 345 U.S. 41, 47 (1953); Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 347-48 (1936) (Brandegee, J. concurring).

An unbridled delegation to defendants -- and self-interested defendants to boot -- to determine, without standards, when and if to give exemptions presents most "grave and doubtful constitutional questions." And it would be a close issue even if it were a delegation to a federal regulatory body and not to the Bell System. See, e.g., A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388 (1935); United States v. Pastor, 557 F.2d 930 (2d Cir. 1977); National Ass'n of Independent Television Producers and Distributors v. F.C.C., 516 F.2d 526 (2d Cir. 1975).

Just this year, this Court, in the Pastor case, reviewed the criteria necessary to uphold the validity of a Congressional delegation: (1) is the delegation "made pursuant to a clear statement of Congressional policy"; (2) is the delegation "governed by precise standards consistent with the statement of policy"; (3) does the delegation "requir[e] that specific findings be made \* \* \* as a condition precedent to regulation"? 557 F. 2d at 941. Surely Section 4252(d) does not satisfy those criteria if it is to be interpreted to mean that defendants are free to tax when they would. There is no policy statement on separation other than the general policy



that there should be tax reduction. There are, of course, no guiding standards (let alone precise ones) other than the implied fiat to get on with the reduction. The statute does not tell the defendants to make any findings; and, indeed, when they separated Centrex charges, defendants just did it and filed their tariffs.

28

Moreover, this Court in the Television Producers and Distributors case came down firmly against broad delegations of even administrative authority when the entity given the power can be motivated by self-interest. A scheme that gave the major television networks the power to decide which programming hours would be "turned back" to local stations was found to be constitutionally offensive because of the likelihood that the networks would follow their own interests:

"[W]e have seen that the licensee is himself prone to favor himself. He should not, in the case of conflict, determine public interest \* \* \*. The Commission cannot leave the choice of which is the best of two worlds to the discretion of the licensee for his private decision on what 'compelling public interest reasons' may be." 516 F.2d at 541; see also, United States v. Pastor, supra, 557 F.2d at 941.

28. The undisputed fact is this: when defendants -- for their own reasons -- decided in 1971 to unbundle, no clearance was sought or obtained from any Government official: not Congress, not Dr. Woodworth, not the IRS. AT&T relied on its intimate knowledge of the Reduction Act's genesis, and found there its power to act (E1406-E1407).



The District Court's answer:  
form over substance

The District Court believed, however, that there was no delegation of the taxing power in this case because the Congress had exercised its power and determined what services or facilities were to be taxed and at what rate. The trial court believed that because an exemption is involved, defendants' action or inaction "merely determines whether or not the duly enacted tax applies in each instance." (184a) (footnote omitted).

But the giving of an exemption, where the taxpayer is subject to the decision of an intermediary, is only another way of Congress saying: "tax or don't tax." The substance of what the District Court condoned here is: "defendants, you may decide to tax your customers or decide not to tax them." There is, thus, a delegation; form should not deny us the view of substance.

As to substance, Judge Weinfeld relied for his conclusion on Helvering v. Lerner Stores Corp., 314 U.S. 463, 466-67 (1941) and Rochester Gas & Electric Corp. v. McGowan, 115 F.2d 953, 955 (2d Cir. 1940), both of which upheld the validity of excess profits and capital stock taxes against the claim that they represented unconstitutional delegations of the taxing power to the taxpayer. These two taxes, adopted by



Congress in 1935, operated so that the declared value of a corporation's capital stock served as the basis for the computation of both its capital stock tax and excess profits tax. Under these statutes it was the corporation itself that in the first instance valued its own capital stock. The higher the declared value of the capital stock, the more capital stock tax the taxpayer paid but the less excess profits tax; and vice versa. The taxpayers urged that, by permitting the corporation to set the declared value of its own capital stock, Congress had unconstitutionally delegated its taxing power. Both this Court and the Supreme Court rejected these contentions on grounds that do not meet our objections in the least.

In Lerner Stores, the Supreme Court held that Congress had merely given the taxpayer a choice but had "fixed the criteria in light of which choice is to be made." 314 U.S. at 468. More importantly, the Court noted that the choice made by the taxpayer would impact only on its own tax liability, thus: "[t]he election which the taxpayer makes cannot affect anyone but itself." Id. This same factor was emphasized by Judge Learned Hand speaking for this Court in the Rochester case. There, meeting the contention that the taxpayer had been delegated the legislative power to tax, Judge Hand stated "statutes frequently grant the privilege of an option to those on whom they impinge \* \* \*." 115 F.2d at 955.



There is a marked difference between the choice given the taxpayers in the Rochester and Lerner Stores cases and the choice afforded the defendants by Section 4252(d) as defendants would read it. The Rochester and Lerner taxpayers had a choice that would affect only their own tax liability. In addition, the choice was to be made within a clear statutory framework developed by Congress: value your capital stock too low and pay high excess profits tax.

Here, however, if the District Court's construction is accepted, the choice is laid on outside private corporations, not on those whose tax liability will be affected by the decision they make. And that choice would have no legal consequence other than to determine whether plaintiffs should be taxed; it would have no effect on defendants. Of course, that is what occurred. In 1971 defendants decided -- for their own reasons -- to reduce the tax on Centrex; their unbundling at that point had no other purpose or effect. If that is not the exercise of the taxing power, what is?

For purposes of the non-delegation principle, these distinctions make all the difference. A primary reason for the rule that the legislature may not delegate its law-making power is that it is our elected officials who are authorized by the Constitution to make the laws that regulate our lives. When Congress acts to return that decision-making function to each of us for a decision which affects no one else, the



principle is not violated; we are in the area of John Stuart Mill's rule of self-governance and freedom is, if anything, enhanced. When, however, Congress delegates its decision-making power to a third party who thus becomes authorized to regulate the lives and fortunes of others, the authority of government passes to the unelected and our voices and, thus our freedoms, are diminished. Cf. Eastlake v. Forest City Enterprises, Inc., 426 U.S. 668, 678 (1976) (the Court sharply distinguishing "the standardless delegation of power to a limited group," from "decision making by the people through the referendum process").

The issue of proper delegation here is troublesome; the rule of statutory construction to avoid the constitutional issue surely applies here as it has in other questionable delegation cases. See National Cable Television Association v. United States, *supra*, 415 U.S. at 341-42; Steele v. Louisville & Nashville R.R., 323 U.S. 192 (1944).

Steele's rule  
of reasonable duty

The Supreme Court has given a guide to a rule-of-reason construction, which avoids the constitutional issue and happily coincides with what has to be the Congressional intent, in Steele v. Louisville & Nashville R.R., *supra*.

In Steele, black minority union members sought to



compel the all-white union management structure to run the union in a manner that was fair to all members without regard to race. The statute at issue, the Federal Railway Labor Act, appeared to confer absolute authority on the elected union management to represent and bind the entire membership. There were no statutory phrases which could even remotely be viewed as imposing a duty of fair representation on the otherwise omnipotent union management.

The Court did not find it necessary to discuss the validity of the sweeping Congressional grant of authority under the rule against standardless delegation. Instead, it found that any grant of authority had to be impliedly conditioned by a rule of fairness and reason:

"[A] principle of general application that the exercise of a granted power to act in behalf of others involves the assumption toward them of a duty to exercise the power in their interest and behalf, and that such a grant of power will not be deemed to dispense with all duty toward those for whom it is exercised unless so expressed." 323 U.S. at 202.

And, the very breadth of the powers held by the union "to act in behalf of others" required the implication of a duty to exercise those powers in the "interest and behalf" of those others.

The Steele Court's imposition -- despite the absence



of any provision on the face of the statute -- of a duty to behave reasonably, to avoid acting out of self-interest, and to consult the interests of those most directly affected by the delegate's actions points the way to a decision here that also meets the Congressional expectations that defendants were going to unbundle and act fairly to give their customers the tax exemption of the Reduction Act: defendants should have unbundled within a reasonable time.

There is surely nothing unfair in this requirement. Like the union in Steele, defendants here had control over the legislatively created benefit. They had both experience and competency, far superior to plaintiffs', with their own equipment and services and superior knowledge of the Reduction Act. And they played all the leading roles. They were responsible for structuring the Centrex offering, fixing its tax consequences and calculating and collecting the tax. In addition, the Bell System had itself initiated the drafting of the Reduction Act, participated intimately in its passage through the legislative process and was fully familiar with its terms. This legislation, admittedly fostered by defendants for reasons of self-interest, has to be construed and should be against its private beneficiaries in a contest with innocent outsiders. See, e.g., Blair v. Chicago, 201 U.S. 400, 463, 467, 469 (1906). And it was for selfish reasons alone -- money-saving reasons and worry about rates and "cans of worms" -- that AT&T

and its satellites delayed unbundling. They -- not the plaintiffs -- should, in fairness, bear the economic burden.

Conclusion: the  
breach and the remedy

There is no question that the Bell System, a licensed monopoly wherever it went, failed its customers. Defendants breached their duties the moment they maintained the tax beyond the time needed to develop the statutory "separate charge." As the defendants' own documents show, the separation process -- using the more time-consuming method of tariff filings rather than permissible bookkeeping allocations -- actually consumed a period of from six weeks to 14 months during 1971 and 1972, while internal procedures were revised and tariffs filed and made effective. Defendants' six to seven year delay in bestowing the Reduction Act's exemption, coupled with the self-interest which ruled their conduct from even before the Reduction Act was signed into law, cannot pass the muster of reasonableness. Defendants are accountable under the Reduction Act. This case should be remanded to move ahead with the trial of the bifurcated damage issue.



Point 4

PLAINTIFFS MAY SUE DEFENDANTS FOR  
RETURN OF EXCISE TAXES WRONGFULLY  
OVERCOLLECTED: THERE IS EXPLICIT  
STATUTORY AUTHORITY FOR THE SUIT  
AND THERE IS NO STATUTORY BAR PRE-  
VENTING IT.-----

Counts II, IV and VI of plaintiffs' complaint alleged that since the effective date of the Reduction Act, defendant operating companies maintained entries on their books and records sufficient to satisfy the separate charge requirements of §4252(d) as interpreted by Revenue Ruling 69-152, 1969-1 Cum. Bull. 289.<sup>29</sup> As a result, we asserted Centrex inter-office charges were, in fact, exempt from the excise tax and all monies collected by defendants in their capacity as collecting agents for the Government (26 U.S.C. §§ 4291, 7501) were not lawfully due and must be returned to plaintiffs by defendants.

The District Court granted summary judgment to the Government, which had been brought in as a third-party defendant, and defendants dismissing these counts without reaching the merits of our claim. It held that while the question "is close

29. Rev. Rul. 69-152, 1969-1 Cum. Bull. 289, stated that the "separate charge" requirement of §4252(d) is met where there are telephone company records which identify in precise detail the monthly charges for equipment and service relating to private communication service and such specific detail is furnished to a telephone subscriber upon request, even though the monthly billings to the subscriber do not show charges for private communication service separately.

and not entirely free from doubt \* \* \* an overall view of the tax collection and refund provisions of the Code \* \* \* shows that aggrieved taxpayers such as plaintiffs must bring their suit against the Government." (196a).

We submit that the District Court decided the "close issue" the wrong way because:

(i) there is a specific section of the Internal Revenue Code that creates "arising-under" jurisdiction against private collectors of excise taxes for an "overcollection" of excise taxes (26 U.S.C. §6415(c)), and the trial court's restriction of the section to "clerical and mechanical errors" is unwarranted by any meaningful legislative history and causes more definitional problems than it solves; and

(ii) neither the specific provision of the Code (26 U.S.C. §7422(a) and (f)(2)), the legislative pattern nor policy relied on by the court below changes the force of that specific and limited overcollection provision.

#### The specific authorization

The right to obtain a "refund" for "overcollection" of federal communications excise taxes appears in rather plain language in Section 6415(c) of the Internal Revenue Code:

"(c) Refund of overcollections. -In case any person required under section 4251, 4261, or 4271 to collect any tax shall make an overcollection of such tax, such person shall, upon proper application, refund such overcollection to the person entitled thereto."

But the District Court said that this statute must be narrowly read to mean overcollections that stem from "clerical



or mechanical" errors -- not from the kind of error (whatever kind it be) alleged here.

We agree that it is too simplistic in a tax statute to say: "Well, that narrowing language isn't in the statute; 'overcollection' means 'overcollection.'" Tax statutes always have to be interpreted; they always have a history; they always seem to have latent ambiguities. (See page 79 n.28 supra). But we begin surely there: overcollection is not modified. Then there is nothing in the legislative history that forces interpolation of the modifiers "clerical" and "mechanical." Indeed, the District Court admitted that "there is little in the legislative history to illuminate the purpose of section 6415(c) \* \* \*." (206a). It believed, however, that what precious little there was required the insertion "clerical or mechanical error." The court's tracing of the history, we submit, cuts against its view.

Judge Weinfeld's syllogism was that Section 6415(c) is a part of an overall pattern that goes back to a predecessor statute (1939 I.R.C. §1715(d)(2), 208a at n.31). However, that statute differs from Section 6415(c) in a material respect. Under the predecessor, the right to make an "application" for a refund from the private collector was geared to the private collector's right, in turn, to take a credit for the overcollection upon a subsequent return without filing for a refund.

Treasury regulations made (and still do) that simple kind of credit -- that is the sort for which the private overcollector could obtain an easy refund -- available only when there are "clerical or mechanical errors." Treas. Reg. 42, Art. 51, 52 (1932); Treas. Reg. §§ 130.77 and 130.78 (1942). The point is that the Congress did away with the gearing language in the 1954 Code: a taxpayer's right under Section 6415(c) is not dependent on the private overcollector's having a right to obtain the easy subsequent credit, the only situation to which the "clerical" and "mechanical" modifiers applied. There is nothing in the House and Senate Reports that would overcome the natural assumption that the elimination of the gearing language in this technical statute, wrought by the hands of technicians, was not unintended and did in fact broaden the scope of that statutory provision.

We suspect there was a good reason to eliminate the modifiers: "the can of interpretive worms" that "clerical" and "mechanical" could create.

The right not otherwise taken away

In any event, the District Court saw Section 7422 of the 1954 Code as the major premise for holding that no suit can be maintained against the private tax collector. Section 7422, however, has to be read in context and against its legislative history. It is dealing on its face with suits against the



Government. Subsection (a) covers refund claims against the Government. On the other hand, the refund claim against a private collector is specifically covered by Section 6415(c).

As to Subsection (f)(2) of Section 7422, it was enacted in 1966 with but two objectives. One was to prevent the concentration of tax refund suits in districts where the various officials of the Internal Revenue Service resided; the other was to eliminate the procedural difficulties arising out of naming as defendants particular officials as opposed to the Government. Both the wording of the statute ("and not against any officer and employee") and the Senate Finance Committee Report make this plain. See S. Rep. No. 1625, 89th Cong., 2d Sess. (1966), reprinted in [1966] U.S. Code Cong. & Ad. News 3676, 3781-82. There is no evidence that Congress, in enacting Section 7422, focused in the slightest on the right to a refund from those who are not the Government or its employees.

#### No great wrench

Finally, the District Court saw this kind of suit as disturbing the orderly scheme for refund suits and bureaucratic procedures.

The short answer is that suits based on Section 6415(c) can be of only a very limited kind; those brought for overcollection of communication and transportation excise taxes

only. There is no severe shaking of the Internal Revenue Service's administrative foundations. And substantial suits involving substantial issues will not go unnoticed by the Treasury, which will either be brought in or can come in itself as amicus.<sup>30</sup>

Furthermore, there can be an element of unfairness to the taxpayers in holding them to suits against the Government. For example, the Reduction Act, as interpreted, exempts intercommunication from tax if the books and records of the Bell System defendants broke down the charges for inter-office communications -- even though the Bell System defendants had not shown the separate charges on their bills to their customers. Thus, private collectors, either negligently or without probable cause and for selfish motives, could conceal the taxpayers' right to an exemption and to receive a refund until the three-year statute of limitations for refund suits against the Government had run.

In sum, neither statutes, nor legislative history, nor overpowering policy reasons require that Section 6415(c)'s statutory basis for an "arising-under" suit be read out of the Internal Revenue Code.

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30. In fact, the Internal Revenue Service has held up passing on refund claims brought by some of the plaintiffs here to wait upon the decision of the courts.



### Conclusion

For the reasons stated in this brief, we urge this Court to hold that (i) the defendants entered into an agreement to maintain the package Centrex rate and that this agreement constituted a restraint of trade in violation of Section 1 of the Sherman Act and (ii) the Reduction Act required the defendants to separate their Centrex rates within a reasonable time of the Act's passage and defendants did not. Either finding compels a remand of this case to the District Court for a determination of the bifurcated damage issue.

Alternatively, plaintiffs request the Court (i) to hold that the District Court improperly granted summary judgment dismissing counts II, IV and VI of the complaint and that plaintiffs may maintain an action for overcollection of federal excise taxes against the defendants and (ii) to remand the case to the District Court for a trial on those counts of the complaint.

Dated: New York, New York  
December 2, 1977

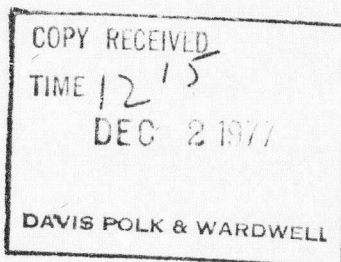
Respectfully submitted,  
Kramer, Lowenstein, Nessen  
Kamin & Soll  
Attorneys for Plaintiffs  
919 Third Avenue  
New York, New York 10022  
212-688-1100

Of Counsel:  
Maurice N. Nessen  
Robert M. Heller  
Michael S. Oberman  
Greg A. Danilow

~~Two and twenty~~ Service of <sup>two (2)</sup> ~~copies~~ copies of  
the within Appellants' Brief is hereby admitted this  
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UNITED STATES ATTORNEY

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